27-Jan-2010

Dear Dr. Caffera:

We have now completed our review of Manuscript EDE-09-141 entitled "The Dissimilar Experience with Economic Instruments to Control Pollution among Latin American Countries: Can We Explain It?" which you submitted to Environment and Development Economics for consideration in the special issue on Latin America. The paper was reviewed by the Guest Editor and three reviewers whose comments are attached to this message. While all three reviewers found the topic very interesting, they raise a large number of points and disagree about the paper's actual contribution. The Guest Editor handling your paper recommends that you be invited to submit a revised version of the paper, and provides specific directions about how a future revision should be developed. He says:

"I think the main problem is that your analysis on the competing hypothesis (institutional capability vs political economy) is not entirely convincing. I agree with that but also I’m not sure how much else can be done in order to improve the analysis (besides improving the editing; which I will come back to later). For example, in many passages of the paper it reads as if Chile, Colombia and Costa Rica are countries that are seriously engaged in the use of economic instruments for environmental protection. At least in the case of Chile, this is far from true. The use of economic instruments (or its expansion if you will) in Chile has been disappointing; there is a law for the wider use of tradeable permits (i.e, cap-and-trade systems) that has been waiting approval in Congress since 1995 (the 1992 offset program in Santiago is not a cap-and-trade program as we generally envision tradeable permits). Congress’s resistance to approve such legislation has much less to do with a (perceived) lack of institutional capabilities and more with political economy reasons. My point is that it is hard to separate both hypotheses (referee No. 2 has a similar reaction), and furthermore, I’m not sure if it's interesting to do so since there are no policy lessons to be drawn. Countries with weak institutions will have a hard time implementing and enforcing environmental laws regardless of whether they rely on economic instruments or more traditional command-and-control instruments. I think the paper comes short of showing that command-and-control instruments are easier to implement under weak institutional capabilities.

**For all these reasons I would like you to reorient the paper towards a more general analysis of the use (and not use) of economic instruments in Latin America rather than testing these two hypotheses.** And I would also like you to comment on how you see the use of these instruments in the future; particularly in a carbon constrained world where part of the develop world will be using these type of instruments. Of course, you want to talk about your competing hypothesis in the paper but not make it the center of your analysis. As I said before, it reads as if your main objective is to test them which you don’t do at the end. **In that sense you will need to read the evidence more carefully in some cases** (I’m not sure why you think the offset program in Santiago was not successful; to me it was certainly unsuccessful if we compare it to a text-book regulation but not if we compare it to the alternative –emissions standard—regulation). **You have most of the material in the paper already. It’s just to present it in a different way.** Note that you will need to talk about environmental policy more generally. To give you an example: It may be that Salvador, to name any country, is not using economic instruments not because of “low capacity” or political economy considerations but simply because it has scattered environmental legislation. While it is easy to understand why taxes don’t get implemented at all (environmental groups don’t like them because they don’t cap emissions and industry does not like them because they are costlier than standards and free permits), it is also important to explain that permits markets, to function well, require a sufficient number of polluting sources. Perhaps pollution in “Salvador” reduces to few large polluting sources located in different parts of the country for which command-and-control is the best approach. In other words, it is important for the reader to understand first the potential for the use of these economic instruments.

Part of the success in the US Acid Rain Program was the universe of polluting sources: large power plants. How many pollution problems in Latin America look like that? Perhaps none.

I also have some more specific comments to go along with the referees’ comments (which I’m not going to replicate here). On page 4 (second paragraph) you said that environmental economists have also advocated economic instruments because of their dynamic incentives. There are many economists, including myself, that do not unambiguously rank economic instruments at the top in providing R&D incentives; in part because previous studies were built around wrong equilibrium concepts. Anyway, Till Requate has a nice survey on the topic in Ecological Economics 2005.

On page 11 you mentioned that the permits program in Santiago was not a “pure permits program” but complemented with an emission standards. I should mention that when emissions are imperfectly monitored it may be socially optimal to combine the permits program with an emission standards (see Montero (2005) in the RAND Journal of Economics: Pollution Markets with Imperfectly Observed Emissions).

On page 12, and closely related to my first comments, you mentioned that Chile, Colombia and Costa Rica are the only countries in the region experimenting with economics instruments. It should also be noticed that the majority of the environmental legislation in those countries is still based on command-and-control instruments. No country has considered for example the use of congestion pricing.

Page 18, bottom. I’m not sure about your 4% figure; it’s very misleading. At the time of implementation, say 1993, the total amount of TSP from stationary sources in Santiago was 8232 kg/day (7442.5+789.5), 90% of which was coming from sources affected by the Compensation Program. You can see Montero (JLE 2002) which you cite in your paper.

On page 31, second paragraph. For your records, I firmly believe that Juan Escudero and Ricardo Katz played a fundamental role in the design and final approval of Santiago’s EC program. There were engineers with good training in economics, so this is consistent with your hypothesis about key players. I’m sure evidence of this can be found in news of the time.

Finally, all three referees agree (and so do I) the paper needs lots of editing before it can be considered for publication in EDE. I would strongly recommend you contact someone to help you with the editing."

Based on the above assessment, with which I agree, I would be willing to consider, without commitment for publication, a revised version that is developed along the lines set out by the Guest Editor.

With regard to the revision procedure, you should first revise your manuscript and then upload it through your Author Center. To do this, log into [http://mc.manuscriptcentral.com/ede](https://correo.um.edu.uy/exchweb/bin/redir.asp?URL=http://mc.manuscriptcentral.com/ede) and enter your Author Center, where you will find your manuscript title listed under "Manuscripts with Decisions." Under "Actions," click on "Create a Revision." When you upload your revised manuscript, you will see your original files. You should delete your original manuscript file, as well as any additional files (e.g., tables, figures, appendices) which do not apply to the revised manuscript.

When you submit your revised manuscript, you should also upload your responses to the reviewers in a separate file called “Responses to Reviewers” and select "Supplementary Files for Review" as the designation of this file. Please explain how you addressed (or did not address) the reviewers' and the Guest Editor's points.

Your revised manuscript should be submitted to Environment and Development Economics by April 30. We look forward to receiving your revision.

Sincerely,

Professor Anastasios Xepapadeas, Editor
Environment and Development Economics