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**The promise and perils of payments for ecosystem services**

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**Abstract**

Created by the interactions of living organisms with their environment, ecosystem services support our society by providing clean air and water, decomposing waste, pollinating flowers, regulating climate and by supplying a host of other benefits. Yet, with rare exception, ecosystem services are neither prized by markets nor explicitly protected by the law. In recent years, an increasing number of initiatives around the world have sought to create markets for services, some dependent on government intervention and some created by entirely private ventures. These experiences have demonstrated that investing in natural capital rather than built capital, can make both economic and policy sense. While markets for ecosystem services hold great potential, they also create challenges. This paper identifies the different types of service markets and examines the challenges created by each, focusing on moral hazards, rent-seeking, free riders and perverse incentives.

**Keywords**

ecosystem services, markets, environmental protection, natural capital, subsidies, perverse incentives, payments

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