

Research



Environmentalists Punish Companies Without Protecting People

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I want to discuss a theoretical idea regarding the economics of pollution, called “externalities.” Despite what some readers might think, I do care about the environment. I just don’t see current government regulations as a way to solve our problems. In fact, those regulations often make the lives of average people worse.

Let’s start with positive externalities. They’re a little harder to come up with but I’ll try to make a good example. Suppose that I buy a rundown house on a nice block. I put a lot of money into fixing it up and doing some amazing landscaping work. Suddenly, this former dump on the block becomes one of the best-looking houses. My property value increases, but so do the property values of my neighbors. They didn’t put a single nickel into my project, yet their property values may rise by thousands without the eyesore next door. This unpaid gain is a positive externality.

In a way, externalities are inefficiencies. We want people to produce positive externalities, but we often have no way of compensating them for doing so. One is not going to make friends by giving a neighbor \$200 and telling him, “It would be great for the whole neighborhood if you would fix your yard.”

The bigger concern is negative externalities

Suppose a coal-powered plant is located near someone’s house. The person buys electricity from the plant at market prices. However, along with the price of electricity, the customer pays an additional price from the increased pollution. The fish nearby have more mercury in their bodies, and the air is horrible. Not every customer pays this price. For those living much farther away from the plant, the externalities are lower. The coal plant does not pay the price of this damage; instead the plant’s neighbors pay the price in a reduced quality of life. Yet pollution is a cost of production.

Just like the positive externalities problem, it’s difficult for an individual to be compensated by the coal plant – especially if the damages are hard to quantify. Furthermore, what’s the price of clean air? I don’t know. For some people who enjoy living in the countryside, it could run in the thousands of dollars per year.

To produce good economic incentives, these externalities must be accounted for. After all, society benefits from production only if value is created. For example, let’s consider a company that manufactures cleaning chemicals for \$4 and sells them for \$5. Society gains by at least \$1. Resources worth \$4 have been transformed into products worth \$5 to someone. The economic incentive is to keep repeating this process until the profit disappears. However, imagine this case: The chemicals cost \$4 and can be sold for \$5, but the process also causes \$2 of environmental damage. The producer doesn’t pay the cost of the environmental damage, but he still has a personal incentive to produce the chemicals. However, society is worse off overall, because the process costs \$6 for only an output of \$5.

This is where the government economists step in with suggestions for taxes. If we place a \$2 tax on the chemical company, then the incentive will be aligned. Yes, that's partially true. However, this doesn't necessarily solve the problem of pollution. Think again about the example of living next to a coal plant. Suppose the government places an extra tax on the plant, and it continues to operate. Who will pay for that tax? Unfortunately, the customers will likely bear some of the cost through higher prices. In fact, the resident will be worse off after the tax. He still bears the damages from pollution, *and* he must pay higher prices. That tax money doesn't go toward compensating the victim of the pollution – it goes to paying additional bureaucrats at the EPA.

Laws that punish companies but don't protect people

Environmentalists almost always support laws that punish companies but don't actually protect people. In fact, they actually make things worse for the regular Joe. If a company meets the regulations and pays its taxes, it can basically do whatever it wants from there. And that's a big reason why I'm not a fan of current regulations. The environmental laws are more often than not just barriers or taxes. They don't do a good job of protecting the little guy.

So what would be my solution? Make companies respect the private property and lives of other people. Don't hold them responsible to the government; rather, hold them directly responsible to individuals in the community. If a company is hurting people and their property, the firm better be writing them checks instead of sending money to the EPA. It's really not a radical idea. We do this in court all the time. If a business hurts someone, it's accountable. For some reason, the same thing doesn't apply to pollution. Rather than devising environmental regulations and taxes, just hold the companies accountable for damages. That should create all sorts of positive incentives regarding pollution and the location of industrial sites.

It's time for Congress to look at new ways to protect people and communities, rather than protect the EPA.

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