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DIFFERENT FORMS OF ENVIRONMENTAL POLICIES FOR THE FIRMS

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Introduction

- The traditional Economic Analysis of Law (EAL) approach about the comparison between different environmental policies is based on the assumption of rational economic agents.

- The Behavioural Economic Analysis of Law (BEAL) approach is based on a sort of “irrational” behaviour that comes more from emotions.

The EAL Approach

- **Public intervention is justified on the base of market failures because of two reasons:**

1)the environment appears as a “public good” that may not be appropriated and has no market price;

2)the damage to the environment is a case of “externality”: it is fully or partly a social cost that is not internalized by the parties causing it

CHOOSING BETWEEN DIFFERENT ENVIRONMENTAL POLICY INSTRUMENTS

THE CHOICE OF ENVIRONMENTAL POLICY INSTRUMENTS IS AN OLD ISSUE:

- Early contribution of Pigou (1932) analyzing the need for an intervention by the state, when private costs diverge from social costs, and suggesting the solution to internalize through taxes the externalities.
- On the contrary, Coase (1960) affirmed that "there is no reason to suppose that governmental regulation is called for simple because the problem is not very well handled by the market or the firm". The key feature is the presence of transaction costs that makes a policy better than other.

THE DEBATE HAS BEEN CONDUCTED FOLLOWING TWO OPPOSITE VIEWS:

- The idea that the choice of policy instruments coming from a market failure is a public matter and the state, as a policy designer, has to select the optimal instrument and to care about its imposition in the public interest.
- The idea to support market based instruments and fight a battle against a sort of "anti-market" mentality.

COMPARISON BETWEEN "PUBLIC-ORIENTED" AND "MARKET ORIENTED" INSTRUMENTS:

- the first are characterized by a public agency with a public definition of conduct rule and a public enforcement system;
- the second are based on market mechanism stimulating indirectly the conduct of the firm and characterized by a private administration and a private enforcement system.

WHICH DIFFERENT ENVIRONMENTAL POLICY INSTRUMENTS?

Command-and-control policies

- Command-and-control policies are the most common system of regulation applied in the environmental sector
- examples: setting of standards.
- the standard-setting instruments consist in the enforcement, by an agency, of a given prevention level

  In the US experience, the EPA provides a clear example of regulation by an independent environmental authority

  (www.epa.org)

ADVANTAGES

- The advantage of centralised agencies is to assure a cost-effectiveness calculation on the base on the expected cost of the damage and on the marginal cost of the different technical preventive instruments.

- Well-defined standards generate the correct incentive for the firm to act with caution and make the best production and prevention decisions

DISADVANTAGES

- The disadvantage of centralised agencies is to not be able to immediately follow the technological changes of the different industrial sectors.

- A big centralised agency can easily be subject to the political influence and to the lobbies pressure (capture)

THE CHOICE BETWEEN

COMMAND-and-CONTROL VS MARKET-BASED REGULATION

First instrument: COMMAND-and-CONTROL REGULATION

Public-oriented instruments, which require the use of a particular technology or the observation of a performance standards, prescribing the maximum amount of pollution that a source can emit

- With perfect information, the centralized agency can systematically assess environmental risks in an optimal way.

Second instrument: MARKET-BASED REGULATION.

Market-based instruments as regulatory devices that shape behavior through price signals rather than explicit instructions

- With a perfect implementation the improvement to environmental quality is obtained at the lowest possible cost