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## **MARKETS, REGULATION, AND ENVIRONMENTAL PROTECTION**

**James L. Huffman\***

The environmental movement has been a great success in many measurable ways. Lake Erie, once an enormous sewer, is now swimmable. The Cayahoga River is no longer in danger of spontaneous combustion. It is once again possible, on occasion, to see the mountains that rim the Los Angeles Basin. In Missoula, people no longer breathe the smoke from tepee burners. In some cases, we know by merely looking that things are better than they were a few decades ago, but we can also document many invisible environmental improvements in parts per million, and perhaps even in lives saved.

### **I. HOW GOES ENVIRONMENTAL REGULATION?**

Most of the environmental improvement has resulted from government regulation—the Clean Air Act, the Clean Water Act, the Resources Conservation and Recovery Act, and so on and so on. These laws have limited permissible emissions, mandated particular technologies, imposed liabilities, and they have forbade some activities. It has been command and control regulation and it appears to have succeeded. But has it been successful? What is the measure of success? Why are our environmental laws and regulators subject to widespread criticism?

Addressing the last question first, we might conclude that the criticism is largely from those whose activities are regulated and upon whom liabilities have been imposed. We should not be surprised that they would object. But the criticism comes not only from the regulated, indeed many polluters prefer the certainties of a regulatory system they know to the uncertainties of some unknown approach to environmental protection. In the dual American traditions of free enterprise and interest group politics, many of the regulated have learned how to profit from environmental regulation.

Notwithstanding the remarkable progress we have made, much of the criticism of environmental regulation comes from traditional environmental organizations and respected environmental advocates. The Environmental Defense Fund (EDF), for

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example, broke with environmental orthodoxy to support the market oriented acid rain provisions of the Clean Air Act Amendments. The more orthodox environmental organizations like the Sierra Club and the Natural Resources Defence Council have generally claimed that environmental regulations do not go far enough and that the environmental regulators are often lax in enforcing those regulations which do exist.

In the West, widespread dissatisfaction among environmentalists about public lands management plays a large part in the economics and politics of the region. For much of the West, the clear-cut slopes of the Bitterroot National Forest are a barometer of environmental quality, just as parts per million of air and water pollution have been the measure of environmental success and failure in the East. The ongoing battles over spotted owls and old growth forests in the Pacific Northwest underscore the dissatisfaction with public land management that the mainline environmental groups share.

## II. THE ORTHODOXY OF COMMAND AND CONTROL

However, the fact that environmentalists are often unhappy, despite the progress made to protect the environment, does not necessarily lead to the conclusion that they are disillusioned with command and control regulation and public management. To the contrary, with occasional exceptions like EDF's support of tradable emissions permits, environmental advocates remain staunchly committed to pollution control through regulation, and resource management through public ownership. The orthodox view is that the shortcomings of our environmental protection efforts result not from relying on the wrong approaches, but from not enough command and control regulation.

Although market approaches to environmental protection have achieved greater currency in public discussions in the last few years, mainstream environmentalism remains firmly committed to the general view that markets are the source of environmental problems and that proactive government is the solution. The accepted theory is that private actors, motivated by a desire for short term profit, ignore the impacts that their actions have on other people, the environment, and future generations. This theory leads to the conclusion that government must intervene by regulating private actions. When, as often happens, the government regulators fail to do their jobs, the orthodox environmentalist remedy is to regulate the regulators through laws like the National Environmental Policy Act and the Federal Lands Planning and Manage-

ment Act.

The case for regulation, to put it in the more sophisticated language of economics, is that external costs associated with private actions exist, which markets do not account for because those who bear those external costs are not parties to the market transactions. It is indisputable that future generations and the environment itself are not market participants. It is often true that some people are excluded from market decisions—sometimes because the cost they suffer is in the form of a denial of a public good, and sometimes because the institutionalized rights system prevents them from effectively participating in market transactions. However, the existence of external costs and private actors' failure to consider environmental impacts do not automatically lead to the conclusion that regulation and public management are the remedies.

Orthodox environmentalism's preference for command and control regulation is rooted less in a sophisticated understanding of public goods and externalities theories than it is in a philosophical objection to capitalism combined with a revival of the progressivist belief in scientific management. The fact that a few individuals made huge fortunes during the late 19th and early 20th century development of the continent does not sit well with most environmentalists, notwithstanding that much of the environmentalists' financial support comes from the foundations made possible by those private fortunes. It is widely believed that a direct correlation exists between economic development and environmental destruction, although the experience of the late 20th century—in Eastern Europe, Latin America, and much of Asia and Africa—demonstrates that the correlation is inverse.

### III. ANOTHER ORTHODOXY: SCIENTIFIC MANAGEMENT

Scientific management was the faith of the conservationists who launched an earlier era of environmentalism at the turn of the century. Emblematic was Gifford Pinchot, first chief of the Forest Service, and close associate of President Theodore Roosevelt. Pinchot brought science to American forestry, and a tradition of professional scientific management to the Forest Service which insulated that agency from most political storms until the middle of the century. Although political controversy would eventually come to the Forest Service, efforts at reform did not abandon the commitment to the Progressive tradition of scientific management.

The modern environmental movement, born with the inspiration of scientists like Rachel Carson and Paul Ehrlich, has adhered

to the Progressive faith. Science, it is argued, will allow us to understand the environmental consequences of our actions and guide our pursuit of solutions. Like the conservationists who preceded them, modern environmentalists have appealed to political institutions while urging that science, not politics, will determine what actions we should take. The Clinton Administration's commitment to the idea of ecosystem management, which is to be launched with a National Biological Survey, promises a new level of sophistication in scientific management.

Like the Progressives before them, the would-be ecosystem managers imagine that science can lead us to a correct substantive result. Science will free us from the vicissitudes of politics in our public decision making. Scientists, relying upon the best scientific understanding of our ecosystem, will tell us what we need to do and how to do it. Their reliance is, of course, a vain hope, rooted either in naivete or deception.

Public decisions are by definition political decisions. They are social choices based upon an aggregation of the values of those who have political influence. Scientists have no special capacity in selecting among competing values. To the extent that we rely upon them, we have simply given them the power to make our social choices for us.

If we recognize that scientific managers ought to have no special role in setting public policy, we might nonetheless look to them for advice on how best to achieve the policy goals we set for ourselves through the political process. This is how we must view the ambition of ecosystem management. We must first accept that ecosystem protection is a good idea, and have some conception of what sort of ecosystems we mean to sustain, and then look to scientists to tell us how to do it.

But even if we agree that ecosystem management is a good idea, and we agree what we mean by that concept, there is a remarkable hubris in thinking that we have the understanding and capacity to manage anything so complex as a natural ecosystem. Perhaps ecosystem management means only that humans should withdraw and leave the management to mother nature. But humans cannot withdraw, indeed some would be so bold as to suggest that humans are part of the ecosystem, so ecosystem management must be understood to mean that we will somehow manage our actions so as to have no impacts on the ecosystem. Most environmentalists would agree that the Department of Interior, faced with far less ambitious objectives, has for a century or more bungled the management of the lands it administers. How, one won-

ders, will Bruce Babbitt get the various agencies in the Department of Interior to become effective ecosystem managers?

#### IV. THE VICE PRESIDENT SAYS THINGS ARE GETTING DYSFUNCTIONAL

As suggested at the outset, the last couple of decades have witnessed significant successes in environmental protection. Rivers and lakes are swimmable, the air is breathable, and hazardous wastes are being cleaned up. Surely this is progress. However, much environmentalist rhetoric would have us believe that we have made barely a dent in the environmental problems we still face, and that our prospects for doing better are apparently not very bright.

Indeed, the Vice President of the United States has concluded from his study of the global environment that society is dysfunctional. That sounds bad. Really bad. For the Vice President, dysfunction is evidenced by scientific reports on the condition of the environment and by the way we live our lives. We are too self-possessed, too greedy, too short-sighted and we have little sense of community. Rather than having made progress over the last decades, it would seem that we have been on a steady slide to environmental armageddon.

Why do the Vice President and most the leaders of our environmental organizations believe that we are at risk of losing the struggle to save the planet? What would be their measure of progress or success? Will a fully implemented system of ecosystem management on the public lands be progress? Will a total ban on chlorofluorocarbons be progress? How about a reduction in global carbon emissions to the pre-1990 level? Will an international agreement to protect endangered species be an environmental success? Perhaps a thriving population of northern spotted owls will convince the Vice President that our society is at least marginally functional.

Of course, different people will have different answers to these questions. Because mainstream environmentalists are committed to scientific management, and often have philosophical objections to capitalism, they tend to measure success not by the quality of human lives or even the quality of the natural environment, but rather by the extent to which we rely on governmental institutions committed to scientific management. The measure of success is more in the method than in the result.

From a social point of view, society must often measure success by the methods used rather than the results achieved. Long

ago, we realized in the law that process is critical to the achievement of the substantive objectives of individuals, particularly in light of the human tendency to abuse the powers of government. The concept of the rule of law is rooted in reliance on the processes of the law as a means of avoiding the rule of man or woman. We resort to process because we cannot agree on substance. Most environmental laws evidence the difficulty of agreeing on substantive standards. Where we have done so in our pollution laws, we have seldom found the means or mustered the will to achieve them. The notable exception has been the Endangered Species Act, which sets a substantive standard of no species loss. However, Congress amended that statute to create a process for overriding that standard.

## V. MARKETS AND ENVIRONMENTAL QUALITY

Thus far, this essay has been critical, arguing that command and control regulation and public management, while delivering some environmental gains, have fallen far short of the ambitions of virtually all mainline environmental groups. What is the alternative? As indicated earlier, the orthodox environmental view seems to be that we should get better at command and control regulation and public management. Environmentalists would have the law reformed to lessen the influence of environmentally destructive interests and to assure that the public interest, rather than special interests, prevails. If this approach is chosen, little reason exists for optimism. I would thus urge an alternative approach, which some have labeled free market environmentalism.

I am not a purist about markets. I am a pragmatist and a realist. Pragmatism leads me to acknowledge that markets sometimes fail in the sense that external costs do befall third parties and some goods are public and therefore subject to free riding. Realism leads me to recognize that politically allocated wealth, with all of its allocational inefficiencies, is not easily reallocated. Command and control regulation and public land management will remain our dominant resource allocation approaches in this country. Therefore, this essay argues both the purist's case for markets and the pragmatic realist's case for markets.

The purist case for markets rests on the proposition that the best measure of resource value is the aggregated choices that individuals make through free market transactions. If Jim offers for sale 100 acres of wilderness for which Plum Creek offers \$100,000 and the Wilderness Society offers \$200,000, Jim will sell to the Wilderness Society, improving Jim's situation while allocating the

resource to its highest valued use.

Only a market assures this sort of result, argue the purists, because all other allocational institutions are political and therefore rely on political influence in one form or another, not upon willingness to pay. In the above example, the timber industry might have more political influence than the wilderness lobby and thus achieve, through the political process, a misallocation of the 100 acres in question. In that example, net social welfare will be diminished by \$100,000 if we do not rely on markets. This hypothetical is not just economic theory. Hundreds of thousands of acres acquired by habitat and ecosystem protection groups belie the common assumption that the timber company will always be able to outbid the wilderness protectors.

Consider another example involving water. In the 1970s we experienced a growing demand for instream water uses. The law of most western states made a diversion a requisite for a water right. Thus, water appropriators could not provide instream water uses. Most instream use advocates urged that states mandate the maintenance of minimum instream flows. These advocates presumed command and control regulation to be the remedy. An alternative was to reform the property institutions on which markets depend by permitting appropriation for instream uses. Many states adopted this reform, but then refused to permit private acquisition of such instream rights. Moreover, western water law continues to impose various restraints on water rights transfers, making it difficult to shift water from lower valued consumptive uses to higher valued instream uses. A properly reformed private rights system combined with a free market would result in significant reallocations of water to instream uses.

As this example indicates, markets often seem to fail when the system of legal rights has failed to provide the necessary context for market transactions. Even in the face of numerous legal obstacles, markets result in the private provision of many environmental benefits. The Nature Conservancy, Ducks Unlimited, and other private organizations do acquire lands for habitat and ecosystem protection. Although it is frowned upon in this state, private landowners do provide excellent habitat for game and fish, which they market to willing purchasers. For the anti-hunters, private landowners market wildlife viewing—even butterfly reserves. For example, the private forests of northern Maine long have supplied recreational opportunities to the large populations of the Northeast.

If we removed the institutional obstacles to market transactions, not the least of which are the massive subsidies that state



and local government provide to destroyers of the environment, environmental protection would surely benefit. Environmentalists should not allow their prejudices against private ownership and personal profit to stand in the way of achieving their environmental objectives. Orthodox environmentalists could profit from understanding a central operating premise among free market environmentalists—namely, incentives matter.

We can plead with our neighbors and countrymen to be better citizens, to do what is right by the environment, but if we want results we must provide incentives. Volunteerism has seldom contributed much to the solving of public problems. Environmentalists have advocated recycling for twenty years or more. While true that recycling centers have existed throughout that period, their impact on the solid waste stream was insignificant until people were given reasons to recycle. Rather than free curbside collection of garbage as a sort of constitutional right, some cities, like Seattle, instituted charges based on weight. This gave people an incentive to recycle as a way of reducing the weight of their garbage. Similarly, Oregon's bottle bill has kept the state's roads free of beverage container litter, and the state pays young people to pick up the litter that motorists have no incentive to dispose of properly. Incentives have gotten results that education could not, although market purists insist that the result achieved is not always a good one. In Portland, where we have free curbside pickup of numerous recyclables, we have substituted mountains of unmarketable glass and paper for landfills.

The concept of tradeable emissions permits gradually is gaining credibility as a legitimate approach to air and water pollution control. The theory is simple. If a government regulation commands a polluter to reduce emissions to a specified level, the polluter has no incentive to emit less than the maximum. If the polluter has a permit to emit a maximum level of pollution and also is allowed to sell a portion of that emission authorization to other polluters, an incentive to reduce pollution below the maximum permitted is created. Under such a system, total pollution can be reduced by environmentalist acquisition and retirement of permits. The acid rain provisions of the Clean Air Act Amendments and a few other laws have provided laboratories to test the theory.

Most environmental groups have opposed the tradeable emissions approach, generally on the ground that no one should have a right to pollute. It is often a moral argument about right and wrong and the nature of things. These moral arguments lead inexorably to the implausible case for zero pollution. In a world of or-

ganic and inorganic processes, with or without humans, zero pollution is neither possible nor desirable. Any moral arguments about pollution, like economic arguments, must seek to define optimality. Environmentalists would be well advised to recognize that marketable emission permits will sometimes get them closer to their optimum than will command and control regulation.

Environmental quality, like other things which people value, does not come at no cost. In the language of economics, clean air has opportunity costs. To have cleaner air we must either give up something or have incentives to figure out how to have our cake and eat it too. The production of goods and the provision of services almost always produce pollution. Markets will sometimes create incentives which produce more goods and services with the same or even less pollution. The consumers of these goods and services, many of which are essential to human survival and dignity, will have the better of moral arguments that pit human welfare against zero pollution.

Another obvious case for markets, notwithstanding the Clinton Administration's ambition to turn the Bureau of Reclamation into a water planning and management agency, is water allocation. Of course, it is no small irony that the Bureau of Reclamation is the would-be water czar. Water allocation throughout the West, and especially in California, is largely the product of massive government intervention by the Bureau of Reclamation and other state and federal agencies.

Some water users in California pay as little as five dollars an acre foot for water. Others pay as much as two thousand dollars an acre foot to desalinate water. This disparity is economic and environmental nonsense of a magnitude that only politics can produce. A reasonably functioning water market in California and the West would go much of the way to eliminating water shortages, even during times of drought. Water markets would provide incentives for efficient water use. History leaves no doubt that such incentives would be more effective than any regulatory and educational campaign that the well-intentioned people at Reclamation might conceive.

Finally, think about the role of the common law in all of this. Markets function on the basis of property rights and contract rights. Market decisions are influenced by liabilities of the tort and criminal law. To achieve environmental benefits through markets, we must restore the role of these common law institutions. Orthodox environmentalism, however, has written off the common law as a source of the environmental problem. In the context of water, the

foregoing discussion evinces the importance of a well-designed system of property rights.

## VI. EVALUATING THE ENVIRONMENTAL PERFORMANCE OF OUR INSTITUTIONS

Apply the following test when evaluating alternative institutions for allocating the scarce resources of our environment: **WHICH INSTITUTIONS WILL ACHIEVE OUR ENVIRONMENTAL GOALS (whatever they may be) AT LEAST COST?** No institutions are perfect. We must not reject an approach because it can be demonstrated to have failed under certain circumstances. Markets fail. Political institutions fail. The question we must ask ourselves is what institutional arrangement is least likely to fail under the circumstances we face. Neither markets nor command and control regulation will solve all of our environmental problems, but the environment will clearly suffer if we do not give markets a chance.