

The Economics of Pollution & Globalization

Introduction:

Since the European continent's environmental regulations are more stringent than those of most areas in North America, it could be argued that a manufacturer in Germany, for example, suffers an economic disadvantage to a company in the United States that produces like goods. This memo will address a number of questions regarding the seeming disparity, and will also present information concerning opposition to globalization and how those concerns are being addressed by both private and public institutions.

1. *If a U.S. plant can legally emit four times as much pollution as a German plant, as is the case in some industries, then which company is better off economically?*

The making of cross-sector comparisons is difficult, since the two companies are geographically dislocated, as well as politically and culturally diverse. From a strictly economic perspective, it is the combination of direct costs (labor, materials) and indirect expenses (overhead), relative to the economy of their individual locations, that will determine which company is better off financially. Should other costs & expenses be identical, then the costs of installing and maintaining more effective pollution-reduction equipment would be mathematically disadvantageous to the German plant.

2. *Whose products should sell for less?*

This is a philosophical rather than an economic question. In the absence of voluntary compliance or legal mandates which would tie prices to altruistic matters, in a free market economy, price is set by the manufacturer/supplier relative to costs, expenses and customer demands, not as a consequence of that company's environmental scruples.

3. *Who should be able to get more market share?*

This question implies that there is or ought to be the imposition of an economic doctrine which favors products and services offered by companies that are environmentally-oriented. Who *ought* to profit more and who *will* profit more are not necessarily synonymous, and if altruism should be a factor in which products to favor, then environmentalism may not be the only issue which would influence a consumer. For example, a company may, indeed, be operating a low-pollution factory, yet be purchasing its raw materials from regions where workers are exploited financially and are toiling in unhealthful surroundings.

Those consumers who make purchases based solely on a "green awareness" may indeed favor environmentally-friendly companies, should they be aware of that company's efforts. However, because of unawareness, or a lack of concern, or numerous other factors having nothing to do with the environment or humanitarianism, market share is determined largely by consumer demand. The answer of who *ought* to profit most, therefore, is determined by which company's products/services appeal most to consumers, meaning that whoever better educates and persuades its target market will garner the greater share. It follows, then, that part of the marketing and branding strategy of an environmentally-conscious company should include appeals to the intrinsically upright nature of its consumers by informing them of the overall value to be gained by purchasing from the more globally-responsible entity. A good example of a company that has successfully created loyalty among the green-aware is that of Patagonia, which not only has a corporate strategy of environmental protection built into all of its operations and processes, but also promotes activism on its Web site. [1]

4. *Why would the German plant ever get more market share?*

Aside from potentially garnering greater market share by persuading customers to favor a more eleemosynary company, a report[2] presented Jan. 27, 2006, at the World Economic Forum in Davos, Switzerland, prepared by Innovest Strategic Value Advisors Inc., an environmental investment research advisory firm, presents strong evidence that companies which have robust environmental governance policies, practices and performance, are highly likely to realize improved financial performance. The 100 most sustainable public corporations, according to the study, outperformed the Morgan Stanley Capital International index by 7.1% during the past five years. Even more impressive is the 23% gain the Global 100 earned during 2005, outperforming the index by 13.5%.

In addition, many communities are providing economic incentives in efforts to attract environmentally-conscientious companies. Kentucky, for example, has implemented a number of tax incentive programs, under the Kentucky Environmental Stewardship Act

(KESA), to increase the location and expansion of businesses producing environmentally friendly products. According to Toyota Corporation, KESA was an important factor in the company's decision last year to begin hybrid production of Toyota Camry at its Georgetown facility. [3]

5. *If a trade bloc specifying more consistent pollution standards were established, would this have a positive effect on the environment?*

In June 2004, a joint initiative of financial institutions was undertaken at the invitation of United Nations Secretary-General Kofi Annan to develop guidelines and recommendations on how to better integrate environmental, social and corporate governance issues in asset management, securities brokerage services and associated research functions. Eighteen financial institutions from 9 countries with total assets under management of over $6 trillion participated in developing a report[4] which concluded that a more globalized, interconnected and competitive world, coupled with the way that environmental, social and corporate governance issues are managed, will be needed to compete successfully during future decades. Companies and members of trade organizations that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets, while at the same time contributing to the sustainable development of the societies in which they operate. Moreover, these issues can have a strong impact on reputation and brands, an increasingly important part of company value.

The report's endorsing institutions stated their commitment to start a process by various trading blocs to further specify and implement the recommendations outlined in the report by means of a series of individual and collaborative efforts. They are also keen, according to the report's executive summary, to start a Global Compact with other stakeholders on ways to implement the recommendations, expressing the belief that only if all actors contribute to the integration of environmental, social and governance issues in investment decisions, can significant improvements in this field be achieved. Endorsing institutions indicated a conviction that a better consideration of environmental, social and governance factors will ultimately contribute to stronger and more resilient investment markets, as well as contribute to the sustainable development of societies.

6. *So then why are protestors from environmental groups opposed to international trade?*

Such opposition groups as Global Exchange, Friends of Earth International, and Our World is Not For Sale indicate that their resistance to "globalism" is not directed so much at the concepts of international trade as to the notion of corporations in wealthy nations banding together to exploit workers, raw materials and the environment in less industrialized, less costly regions.[5] Trade Blocs are not subject to democratic control, opponents feel, and therefore cannot serve the interests of the people at large. Due to their large-scale objectives, blocs would also intensify long-standing problems, such as the deterioration of the environment, say globalism protesters. Coupled with that, critics suggest that world trade could actually decline as more and more regions form trading blocs - such as those between the US, Canada & Mexico (NAFTA), the European Union, he Association of Southeast Asian Nations (ASEAN), and South America's Mercosur – in that such blocs would tend to become more protective of their member nations, resulting in consumers being presented with fewer choices, while producers would lose sales in foreign markets.

Conclusion:

The information presented in this memo demonstrates that, despite the short-term cash flow disadvantages to a firm that invests in pollution control production methods, incorporating policies of environmentalism and consumer awareness into its strategy, can result in greater and more enduring shareholder value, thereby offsetting the immediate financial advantages enjoyed by a less earth-conscious manufacturer. Further, as detailed in the 2004 United Nations study [4], a specific goal of the report's endorsing institutions is to formulate policies whereby various trading blocs can better contribute to the sustainable development of all the nations and peoples of the world, in consort with measures to better protect the environment, thereby addressing many of the concerns voiced by opponents of globalization.

References

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