President Biden is reassessing environmental rules and regulations promulgated by the Trump administration, raising questions on whether new environmental rules could present obstacles to economic growth. (ddp)

US Public Policy

Do environmental regulations enhance competitiveness?

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Within days of assuming office on 20 January, President Biden had revoked some of his predecessor's executive orders and announced a reassessment of more than 100 other environmental rules and regulations promulgated by the Trump Administration. In the wake of the election, we have been asked by clients whether the imposition of new rules governing items such as greenhouse gas emissions and the extraction of natural resources presents an obstacle to economic growth. To answer the question, a brief review of two competing economic theories is appropriate.

In the latter half of the twentieth century, it was common to view environmental regulations as an incremental net cost on business and an obstacle to global competitiveness. And it's easy to understand why thetheory prevailed. Some portion of the labor and capital, which otherwisewould have been engaged in industrial production, must be divertedtowards compliance with government regulations. The diversion is aquantifiable cost to business in the form of personnel expenditures or theexpenditure of capital for emission controls.

Michael Porter, an economist at Harvard, challenged the hypothesis 30 years ago. In a seminal research paper published in 1991, Porter argued that well-designed and consistently-enforced environmental standards actually enhance the global competitiveness of US industry.[1]

He argued that policymakers have focused incorrectly on the static cost of environmental regulation, while ignoring the more important offsetting productivity benefits from innovation. Complying with new pollution standards, for example, forces industries to use raw materials more efficiently and inevitably reveals flaws in the production process.

In a subsequent paper, he used the example of a semiconductor manufacturing facility where pollution control requirements required 13 changes to the production process. Twelve of the changes resulted in cost reductions.[2]

Theories, of course, are a dime a dozen, and business owners are the ones obliged to abide by new regulations. Porter concedes that the US has a mixed record when it comes to environmental regulation. While coherent standards can improve productivity over the long run, the US has a tendency to deter innovation by mandating specific technologies and imposing unrealistic timeframes for adoption.

The US is now faced with a formidable industrial competitor in China. As the Biden Administration begins to roll out new regulations focused on climate change, the Porter Hypothesis will be tested again. To the extent that new rules focus on the overall objectives of a cleaner environment and avoid the imposition of rigid solutions from inside the Washington Beltway, a more stringent regulatory environment doesn't need to undermine longer-term economic growth.

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This content is a product of the Chief Investment Office.

[1] Stefan Ambec, Mark Cohen, Stewart Elgie, and Paul Lanoie, "The Porter Hypothesis at 20: Can Environmental Regulation Enhance Innovation and Competitiveness", University of Chicago, Review of Environmental Economics and Policy, Volume 7, Number 1, 2010

[2] Michael E. Porter and Claas van der Linde, "Green and Competitive: Ending the Stalemate", Harvard Business Review, September 1995.