

## Economics and the Environment (summary)

**Main Question:** Should economic policy decide, or at least help us decide, environmental policy? That is, should economic efficiency serve as a criterion for environmental policy?

**Further questions relevant to the environmental issues. Does the market system ...**

- (1) ... provide the most just distribution of resources?
- (2) ... adequately protect human health and safety?
- (3) ... recognize environmental values?

**The Basic Economic Problem:** How do we meet our material needs in the face of scarce resources?

**Premises of Economics**

- (1) *Maximize* the satisfaction of preferences (see *Pareto Optimality*).
- (2) These preferences are *subjective*,
- (3) *substitutable*, and
- (4) *unlimited*.

**Economic efficiency is the maximal satisfaction of preferences.** This is normally understood in terms of Pareto Optimality:

An economic system is **Pareto optimal** (= “maximally efficient”) if it is not possible to rearrange production and consumption activity so as to make at least one person better off except by making one or more other individuals worse off.

**In practice, efficient use of resources can be decided using either of two criteria:**

**Pareto Criterion:** “Accept only those policies that benefit some people while harming no one.”

**Potential Compensation Criterion** (Kaldor-Hicks): “Accept only those policies where the benefits outweigh the costs (measured monetarily).”

**Problems with the Pareto Criterion**

- (1) Too strict (not practical)
- (2) Assumes the *status quo*
- (3) Assumes all transactions are voluntary and well-informed.
- (4) Includes only economic players

**Market failure (= inefficient market).** Causes of market failure include:

- (1) imperfect competition
- (2) asymmetric information and imperfect information
- (3) externalities
- (4) not all goods/values have a market price

**Externalities:** some benefit or harm (resulting from the production of some good or service) that is not reflected in the market price of that good or service. They are either **positive** or **negative**.

**Avoiding Externalities**

- (1) Seek voluntary restraints.
- (2) Re-arrange property rights, and rely on tort law to control for damages.
- (3) Attach penalties and compensation and/or enjoin the nuisance (through government regulation and action).

**Pricing the Unpriced:** through shadow pricing

**BUT...**

Even if we can satisfy these problems, and through various regulations are able to develop an efficient market, would this still be the best way to decide the above questions? Several kinds of criticisms can be raised at this point:

- (1) Soft numbers
- (2) Economic reasoning *devalues people* (Sagoff)
- (3) Economic reasoning favors the wealthy.
- (4) Economic reasoning is anthropocentric.
- (5) Market-system assumptions.