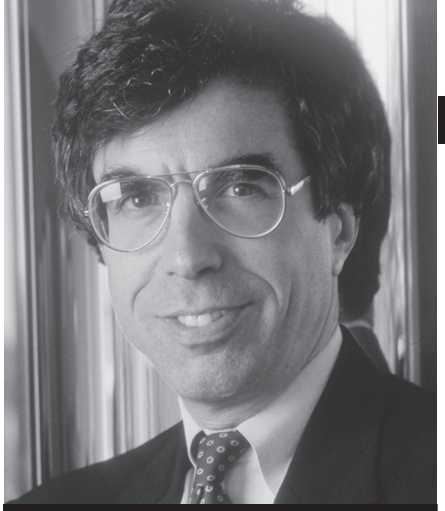

By Robert N. Stavins

The Making Of A Conventional Wisdom

Despite the potential cost-effectiveness of market-based policy instruments, such as pollution taxes and tradeable permits, conventional approaches — including design and uniform performance standards — have been the mainstay of U.S. environmental policy since before the first Earth Day. Gradually, however, the political process has become more receptive to innovative, market-based strategies.

In the 1980s, tradeable-permit systems were used to accomplish the phasedown of lead in gasoline (saving about $250 million per year) and to facilitate the phaseout of CFCs. In the 1990s, they were used to implement stricter air pollution controls in the Los Angeles metropolitan region and — most important of all — to reduce sulfur dioxide and hence acid rain by 50 percent under the 1990 Clean Air Act Amendments (saving about $1 billion per year in abatement costs).

Why has there been a relatively recent rise in the use of market-based approaches? For academics like me, it would be gratifying to believe that increased understanding of market-based instruments had played a large part in fostering their increased political acceptance, but how important has this really been? In 1981, Steven Kelman surveyed congressional staff members and found that support and opposition to market-based environmental policy instruments was based largely on ideological grounds: Republicans, who supported the concept of economic-incentive approaches, offered as a reason the assertion that "the free market works," or "less government intervention" is desirable, without any real awareness or understanding of the economic arguments for market-based programs. Likewise, Democratic opposition was based largely upon ideological factors, with little or no apparent understanding of the real advantages or disadvantages of the various instruments. What would happen if we were to replicate Kelman's survey today? My refutable hypothesis is that we would find increased support from Republicans, greatly increased support from Democrats, but insufficient improvements in understanding to explain these changes. So what else has mattered?

First, one factor has been increased pollution control costs, which have led to greater demand for cost-effective instruments. By the late 1980s, even political liberals and environmentalists were beginning to question whether conventional regulations could produce further gains in environmental quality. During the previous 20 years, pollution abatement costs had continually increased, as stricter standards moved the private sector up the marginal abatement-cost curve. By 1990, U.S. pollution control costs had reached $125 billion annually, nearly a 300-percent increase in real terms from 1972 levels.

Second, a factor that became important in the late 1980s was strong, vocal support from some segments of the environmental community. By supporting tradeable permits for acid rain control, Environmental Defense seized a market niche in the environmental movement, and successfully distinguished itself from other groups. Related to this, a third factor was that the SO_2 allowance trading program, the leaded gasoline phasedown, and the CFC phaseout were all designed to reduce emissions, not simply to reallocate them cost-effectively among sources. Market-based instruments are most likely to be politically acceptable when proposed to achieve environmental improvements that would not otherwise be achieved.

Fourth, deliberations regarding the SO_2 allowance system, the lead system, and CFC trading differed from previous attempts by economists to influence environmental policy in an important way: the separation of ends from means; that is, the separation of consideration of goals and targets from the policy instruments used to achieve those targets. By accepting — implicitly or otherwise — the politically identified (and potentially inefficient) goal, the 10-million-ton reduction of SO_2 emissions, economists were able to focus successfully on the importance of adopting a cost-effective means of achieving that goal.

Fifth, acid rain was an unregulated problem until the SO_2 allowance trading program of 1990; the same can be said for leaded gasoline and CFCs. Hence, there were no existing constituencies — in the private sector, the environmental advocacy community, or government — for the status quo. We should be more optimistic about introducing market-based instruments for "new" problems, such as global climate change, than for already highly regulated problems.

Sixth, by the late 1980s, there had already been a shift of the political center toward using markets to solve social problems. The Bush 41 administration, which proposed the SO_2 program, was "moderate Republican," and phrases such as "fiscally responsible environmental protection" and "harnessing market forces to protect the environment" do have the sound of quintessential moderate Republican issues. And support for market-oriented solutions to social problems had been increasing across the political spectrum for the previous 15 years, as was evidenced by deregulation of the airline, telecommunications, trucking, railroad, and banking industries. Indeed, by the mid-1990s, the concept "market-based environmental policy" had evolved from being politically problematic to politically attractive.

And finally, the SO_2 program — like any major innovation in public policy — can partly be attributed to a healthy dose of chance that placed specific persons in key positions, in this case at the White House, EPA, the Congress, and environmental organizations. The result was what remains the golden era in the United States for market-based environmental strategies.

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