

RESOURCE MISALLOCATION, EXTERNALITIES AND ENVIRONMENTALISM: A U.S.-CANADIAN ANALYSIS

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It is a truism among economists that only if the full costs and benefits of economic activity are taken into account by the entrepreneur, will resources be allocated in a Pareto Optimal manner. Under present economic conditions, however, some manufacturers are able to impose costs, particularly pollution or disposal costs, onto third parties. As a result, the actual social costs of such activities are greater than the recorded private costs. At present, the benefits of these goods need be equal to or greater than only the lower private costs, not the higher social costs, if the enterprise is to be able to at least break even and thus continue in operation. This being the case, it follows that the value of at least some of these presently produced goods and services will fall below the total or social costs, and should not be produced at all, if wealth is to be maximized.

So far, this argument is straightforward, and unobjectionable. Indeed, it constitutes no more than the logical implications of the basic axioms of microeconomic price theory, as applied to environmental issues. This, unfortunately, does not apply to the next step typically made in this line of reasoning, which consists of the claim that our economy, at present, is organized along free enterprise lines, and that these negative externality -- induced misallocations stem from that system.

The point of departure taken in this paper, in contrast, is the hypothesis that this "economic failure" is indeed a concomitant of our present system, but that it is due to government failure, not market failure¹. On this thesis, a clear definition of property rights, and the defense thereof, is a necessary underpinning of the market system.

We shall attempt to show that while the government has claimed a monopoly right to engage in just such activities, it has fallen short of this goal. Further, each of these cases of failure, it will be claimed, is the cause of a resource misallocating externality; if the externality is to be internalized, it will not be accomplished by yet further incursions of government into economic planning, but rather by confining government to its traditional roles of defining and defending private property rights.

This analysis also has profound implications for the environment. It is because of government failure to protect private property owners against the depredations of trespassers that our air, water, forest and wild animal resources are presently endangered. If the ecological system is to be better protected, the market will have to be called upon to play a more significant role. But it can only do so if market prices reflect the true costs of producing goods; that is, if the market can generate prices which take into account all costs, specifically including disposal or pollution costs. Only in that way will social costs tend to equal private costs.

¹It has been correctly argued that there is both market and government failure, and that therefore the existence of the former does not justify state ameliorative action. In this paper we adopt a stronger thesis, namely, that no market failure has been shown to exist in the environmental field, and that all alleged cases are really instances of the governmental failure to clearly define, or aggressively protect, private property rights. This is not to say that free enterprise is "perfect." Nothing composed of fallible human beings can attain that honorific, at least on this side of the Garden of Eden. It is, however, to deny that any systematic, pervasive or serious "flaw" in this system has so far been uncovered.

