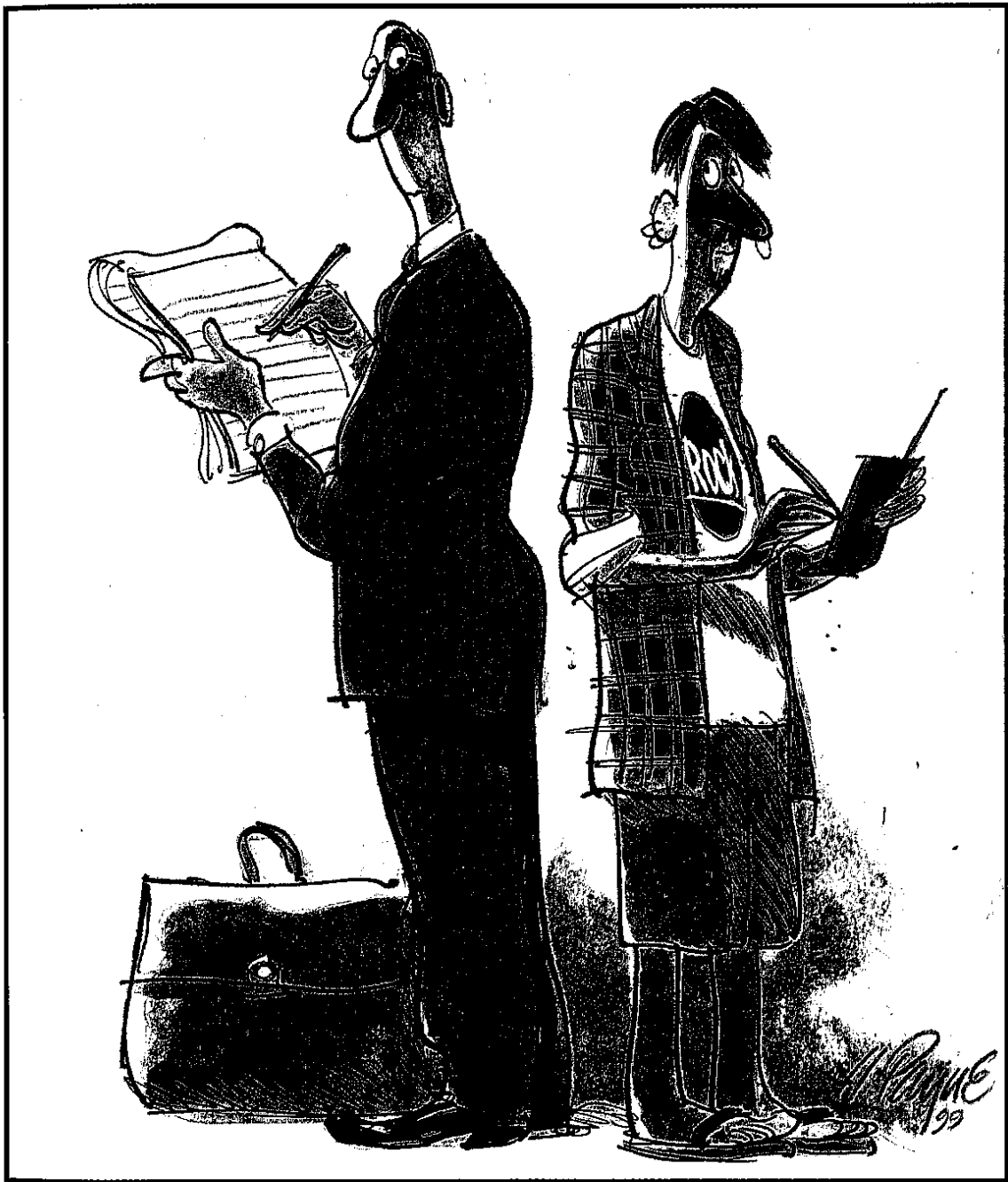


# THE Environmental Forum®

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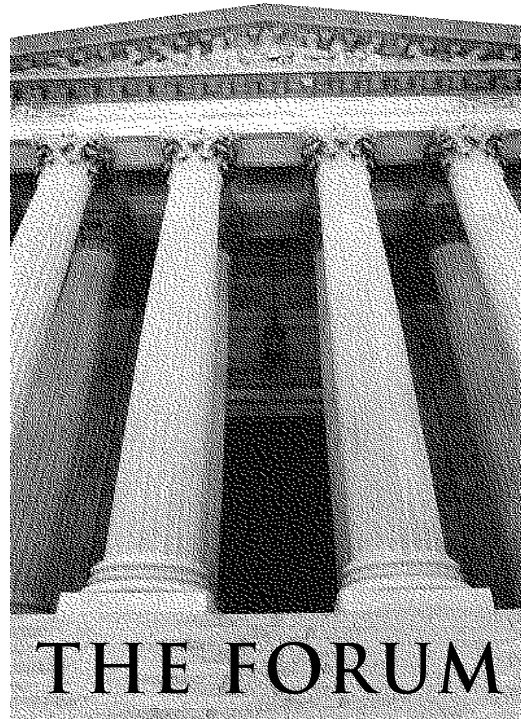
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## Environmental Law Meets E-Commerce

THE END OF CITIZEN STANDING TO ENFORCE THE LAW?  
CAN REGS BE DESIGNED TO GIVE BUSINESS A FREE LUNCH?



## **The Porter Hypothesis: Can Business Benefit Economically From Regulation?**

**T**he conventional wisdom is that environmental regulation extracts costs from business to increase social benefits. Why else would economists talk about cost-benefit analysis as a means of evaluating regulations? In 1991, however, Michael E. Porter, a professor at Harvard Business School and author of *The Competitive Advantage of Nations*, declared in an article in *Scientific American* that in fact “the Chicken Little mind set that regulation inevitably leads to costs . . . must be discarded.” Porter then raised the ante: “The nations with the most rigorous [environmental] requirements often lead in exports of affected products” and that strict environmental codes “may foster competitiveness.” The reason: properly constructed, regulations encourage innovation and efficiency. The assertion that in the right circumstances businesses themselves could benefit from environmental regulation became known as the Porter Hypothesis.

Needless to say, there were many dissenters, and the debate was joined. It continues to this day. Last spring, the Environmental Law Institute and the Center for the Study and Improvement of Regulation at Carnegie Mellon University sponsored a workshop to examine the evidence, including the costs to industry of regulation, innovation by industry in the face of regulation, and other economic effects such as competitiveness. At the end of the day, it was clear that the issue is far from being settled.

We asked a group of participants and other commentators to answer a simple question: “Almost a decade after it was set forth, what in fact do we know about the validity of the Porter Hypothesis?”

## **Importance Of Business Dynamics**

DAVID REJESKI

**A**s one who has watched the debate around the Porter Hypothesis unfold across hundreds of pages of research and management journals, I have given up any hope that the hypothesis will be unequivocally proven. The search for empirical proof may be intellectually stimulating but it misses an important implication of Porter's thinking. His intent was not just to present us with an interesting research hypothesis. At a more general level, it is a challenge to government institutions to pay attention to the dynamics of competition.

Many of our regulations, and much of our thinking about how to regulate, were formulated to deal with an end-of-pipe world dominated by vertically integrated companies. The rules governing competition have changed, and when strategies for competition change, so do a host of other variables governing production and commerce, including transaction costs, supply chain

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relations, the capacity for technological innovation, coordination, organizational flexibility, capital requirements, input costs, and entry barriers. These changes bring about corresponding changes in the effectiveness of regulations and, as importantly, the ability to achieve environmental results through non-regulatory measures aimed at these variables.

More recently, Porter has noted, "Now that companies can source capital, goods, information, and technology from around the world, often with the click of a mouse, much of the conventional wisdom about how companies and nations compete needs to be overhauled." Regulations based on "conventional wisdom" may not work well in industries that are horizontally structured, dominated by fast-changing strategic alliances, or competing on the basis of regional clusters.

If competition is dynamic, what does that mean for regulation? Management guru Peter Drucker has pointed out that the theory of business is no more than a hypothesis and has to be tested continually. The same is true of environmental policy. Built into our regulatory organizations must be ways to systemically monitor and periodically test the theory of regulation and the models of business upon which regulation is designed and constructed. In the end, the theory and practice of environmental regulation must be constantly informed by the theory and practice of business.

Michael Porter has something to teach us not just because of what he has written, but because he has the ability to constantly question the assumptions governing the world around him. This is the primary quality that environmental leaders will need in the 21st century. In a world where our entire knowledge base is doubling every seven years, unchallenged assumptions — about how society operates, the limits of technology, the mission of our organizations, and the people and competencies needed to accomplish that mission — will constitute the greatest threat to effective environmental policy. Those of us who develop and implement environmental

policy should not be looking backward with smug satisfaction at our regulatory history but looking forward with curiosity and the question "How will the world change today?"

*David Rejeski is a Policy Advisor in EPA's Office of Policy, Planning, and Evaluation. At present, he is an agency representative at the Council on Environmental Quality, where he serves as the Executive Director of the Environmental Technology Task Force.*