Environmental Accountability Beyond Compliance: Externalities and Accounting

Arthur J. Jacobson
Benjamin N. Cardozo School of Law, ajacobsn@yu.edu

Follow this and additional works at: https://larc.cardozo.yu.edu/faculty-articles

Recommended Citation
Available at: https://larc.cardozo.yu.edu/faculty-articles/85

This Article is brought to you for free and open access by the Faculty at LARC @ Cardozo Law. It has been accepted for inclusion in Articles by an authorized administrator of LARC @ Cardozo Law. For more information, please contact christine.george@yu.edu, ingrid.mattson@yu.edu.
The title of this paper really poses a question: Should corporations try to do more for the environment than the legal system requires? If so, what are corporations best equipped to do?

The answers to either question are by no means obvious. The reason the answers are not obvious stems from the nature of the environmental problem. The environmental problem is above all the problem of externalities.

In a decentralized economy, where all costs of activities appear as real costs to economic actors, there would be no environmental problem. We could quibble about the meaning of cost, but in principle this statement is correct. The pricing mechanism in such an economy would provide as much information as any economic actor needs, without reference to the environment. The only issue in such an economy is whether economic actors have sufficiently accurate cost accounting systems to successfully take account of all real costs. If laws and legal enforcement mercilessly relate costs back to the generators of the costs, whether through private damage actions, or through administrative or criminal enforcement actions, then the economic actors would have ample incentive to develop adequate accounting systems.

The reason we have an environmental problem is that many costs of activities do not show up as real costs to economic actors. Laws and legal enforcement do not adequately relate costs back to the generators of the costs. Economic actors do not have adequate incentives for developing accounting systems that capture all real costs.

The environmental problem thus has two components. First, law and legal enforcement must relate costs back to the generators of the costs. Second, cost accounting systems must provide information about the costs to the generators.

The question posed by this paper necessarily assumes a failure in one or both of these components. Corporate action "beyond compliance" assumes either that the law or legal enforcement does not relate...
costs back to the generators of the costs, or that cost accounting systems fail to provide accurate information about the costs to the generators.

As to the first possible failure—a failure of law or legal enforcement—there are two conceptual difficulties in urging corporate action "beyond compliance."

First, to the degree that the failure of law or legal enforcement is a result of political, not technical, factors, it is unclear what special ethical mandate corporate managers have to spend corporate funds in excess of the requirements imposed by the open and free operation of democratic government. Nothing in corporate law especially prohibits such private ethical action. We have a long tradition of corporate charity\(^1\) and the ALI guidelines now specifically protect some profit-threatening ethical decisions.\(^2\) But it is equally true that nothing in corporate law especially recommends private ethical action. The premise of grassroots movements such as the Valdez Principles\(^3\) and

---

\(^1\) See, e.g., A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 161, 98 A.2d 581, 590 (finding that a corporate contribution to a university in support of research "was a lawful exercise of the corporation's implied and incidental powers under common-law principles and that it came within the express authority of the pertinent state legislation"); appeal dismissed, 346 U.S. 861 (1953); Garrett, Corporate Donations, 22 Bus. LAW. 297, 301 (1967) ("Donations should be reasonable in amount ..., bear some reasonable relation to the corporation's interest, and not be so 'remote and fanciful' as to excite the opposition of shareholders whose property is being used."). But see Prunty, Love and the Business Corporation, 46 VA. L. REV. 467 (1960) ("The conversion of a business corporation into an eleemosynary institution would still be improper, as would be the giving away of all or a substantial part of the corporate assets or a constant unbalanced feeding of a 'pet' charity, without regard for the corporate welfare.").

\(^2\) PRINCIPLES OF CORPORATE GOVERNANCE § 2.01 (Tent. Draft No. 4, 1985).

\(^3\) The pension funds of New York City and California and other investors joined with environmental groups and religious organizations ... to introduce a code of conduct to judge which corporations are environmentally responsible. ... The 10-point code has been named the Valdez Principles, recalling the disastrous oil spill by the Exxon Valdez oil tanker off the Alaska coast. It calls on companies to address the effect of both product and production processes on employees, communities and the environment. It also includes requirements that companies appoint environmental experts to their boards and conduct and publicize an annual audit of their compliance with the code.

... The code was drawn up by the Coalition for Environmentally Responsible Economies. Its backers include the Social Investment Forum, which represents 325 fund managers and investment advisors, ... and the National Council of Churches' Interfaith Center on Corporate Responsibility.

... [T]he National Audubon Society [is] one of 14 environmental groups backing the effort.


Green Seal Inc. is failure of the democratic political system. These movements must be able to defend the proposition that private interest group activities amounting to boycott are democratically and ethically superior to the normal channels of political action. This is not at all obvious.

Second, to the degree that corporate practice sets a standard for compliance in civil actions, private ethical action, if generalized, inevitably raises the standard. What was once private ethical action would then inexorably become the legal standard. What a corporation may be willing to do from ethical motivations, it may not wish to be legally forced to do. After all, an ethical corporation gets collateral benefits from ethical action—public relations, employee morale, and so forth—which it does not get from mere compliance. Furthermore, corporations would have no guarantee that ethical imperatives would be satisfied once the old level of ethical action (that is, action once considered “beyond compliance”) becomes incorporated in legal standards (that is, action considered mere compliance). Ethical forces have their own, self-interested reasons for staying in business. Corporations would thus be facing an endless ethical escalator. They might rationally choose not to get on in the first place.

As to the second failure—a failure of cost accounting systems to provide accurate information to cost generators about externalities—the accounting profession remains, I believe, totally unfit to even begin redressing the failure. We still depend, for the most part, on the victims of externalities to do the accounting for cost generators, and victims will do the accounting only when the legal system gives them the incentive to do so: a legal claim. Take the struggle over alternative energy sources. Do we have any environmental accounting system for telling whether coal is superior to nuclear power? I consider the lack of an adequate system for economic actors to account for externalities to be the chief obstacle to making rational decisions about environmental cost-saving measures beyond compliance.5

Even assuming a solution to these two problems, I believe that no one has successfully solved the corporate management problem of

---

4 Green Seal Inc., a private, nonprofit concern, plans to have panels certify products that reduce waste and pollution or promote recycling. Meier, It's Green and Growing Fast, But Is It Good for the Earth?, N.Y. Times, April 21, 1990, at 48, col. 4. Green Seal and a similar, for-profit organization, Scientific Certification Systems, Inc., are modelled on government panels in Germany, Canada and Japan. Id.

5 The Pace University Center for Environmental Legal Studies recently published a pioneering study of the environmental effects of generating electricity. See R. OTTINGER, D. WOOLEY, N. ROBINSON, D. HODAS & S BABB, ENVIRONMENTAL COSTS OF ELECTRICITY (1990). The Pace team wrestles with the economic problems inherent in measuring environmental costs and benefits. The project bristles with difficulties. Nevertheless, by taking con-
weaving environmental decision making into ordinary managerial and budgeting decisions. Frank Friedman addresses this problem in his paper, but I have yet to be convinced that any solution is possible. If a corporation disperses environmental decision making to divisions, then environmental considerations will always lose out to the need to show a profit. If, on the other hand, the corporation unifies environmental decision making at the corporate level, then divisions will inevitably frustrate the efforts of the central environmental decision maker to gather relevant information.

Despite all these difficulties, I believe, nonetheless, that corporations have an authentic role to play in environmental protection beyond compliance. It seems to me that corporations can provide organizational facilities to employees, and possibly even to communities. A trivial, but potentially important, example is car pooling. American government is always best when it plays the role of providing facilities to the economy. Corporations—as private sector “governments”—also have a role in providing these cost-saving facilities. Nevertheless, a caveat is still in order. Inasmuch as corporations assume the costs of these facilities, the economic incentives to their users can easily distort the efficient allocation of resources. If corporations do not “pass on” these costs, then inefficient overuse of the facilities they provide is inevitable.

For example, the Pace team has performed an invaluable service for future workers in the field.

For example, the Pace team has performed an invaluable service for future workers in the field. For example, the Pace study assumes that costs and benefits must be regarded as such by some human actor. id at 54. The study disregards costs or benefits to non-humans. This is an ethically and economically controversial position.

The Pace study does not pursue the problem of environmental accounting, since its authors maintain that environmental costs appear only as social costs, those which the accounting systems of individual economic actors do not “internalize.” id at 62-63. Since individual economic actors fail to account for environmental costs, it is difficult to see how the political system can rationally assess them. Judging what economic actors would be willing to pay to avoid such costs must be hypothetical—i.e., intolerably value-laden from a rigorous economic perspective.

From a theoretical perspective, the real solution to the environmental problem seems to be assigning liabilities and constructing accounting systems to force economic actors to internalize all costs associated with their activities. From this perspective, “environmental accounting” is an oxymoron.

Economists, to their credit, have begun to address the need to account for traditionally undervalued environmental resources. See Passell, Rebel Economists Add Ecological Cost to Price of Progress, N.Y. Times, Nov. 27, 1990, at CI, col. 5. The New York Times article reports that the United Nations Statistical Office is working on a general framework for environment and natural resource accounting.