California Competitiveness and Environmental Regulation: Up Close with James Strock

by Sheryl Schaffner Freeman

Lately, there has been a lot of talk about the heavy burden of environmental regulation on California businesses. Students in law school hear that complaint countered by the "internalization" theory. Internalization is an economic theory about the appropriateness and desirability of environmental regulation forcing business and industry to internalize costs, through environmental regulation, instead of externalizing these costs onto the public's health and natural resource base.

More intensely and with increasing frequency we are confronted with the prospect of business and industry simply refusing (or being unable) to cope with the regulatory burden and therefore abandoning California. This scenario has prompted diverse reactions. A response at one end of the spectrum might be "Good enough. We don't need dirty industry or sloppy business anyway. Besides, California is overpopulated as it is." Or, to paraphrase another, opposite reaction: "Gut the regulations. Business is the lifeblood of California, especially in these tough economic times."

Here, James Strock, Secretary for Environmental Protection at the new California Environmental Protection Agency, presents a third view, one that attempts to strike a balance between these two extremes. The following is a speech Mr. Strock recently gave, outlining his views on the issue of California economic competitiveness and environmental regulation. A short interview conducted by Ms. Freeman follows.

SPEECH TO THE ECO EXPOGREEN BUSINESS CONFERENCE AND TRADE SHOW
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"California's Competitive Environment"

by James M. Strock
Secretary for Environmental Protection

Economics and Environmental Protection

Traditionally many people, ranging from Barry Commoner on the left to business executives on the right, have viewed environmental improvement and economic growth as incompatible. More and more people are now recognizing the wisdom of Governor Wilson's view that environmental and economic progress are not only compatible, but it is necessary that they be brought together. We are seeing that in a number of areas, including:

--marketable permits--where the South Coast Air Quality Management District is leading the world in moving toward an enforceable trading system;

--environmental accounting--where from the United Nations to Germany to England to Norway to California--efforts are underway to integrate environmental "externalities" into public and private accounting;

--trade zones are being developed or considered with environmental issues increasingly at the forefront;

--environmental labelling--to provide consumers with the information necessary to allow them to reflect their environmental values in purchasing decisions; and

--pollution prevention--referring to a range of activities aimed at preventing the creation of pollution in the first instance, rather than dealing with it solely at point of transport from a pipe or a stack.

Of course, the market for environmental protection is unusual in that it must be created, nurtured and sustained by government action. And the potential market is immense in the United States alone. It is projected that as much as 3% of our gross national product will be devoted to environmental investment by the year 2000. At the present time, as a nation, we invest more than $100 billion annually in environmental compliance. Sound economic thinking not only suggests market opportunities abound, but that market mechanisms can lead to more efficient regulation.

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California: Poised for Leadership

Just as California has led the nation, indeed the world, in the first phase of environmental regulation over the past generation, so we are well positioned to lead in the coming generation. Among our advantages:

--high environmental standards, including energy standards;

--a strong entrepreneurial culture, enriched by a continuing infusion of immigrants from within and outside the United States;

--our location and historic connections to the Pacific Rim, Mexico and central and South America, as well as longstanding and significant European investment in our state;

--our longstanding role as host to federal facilities of various types, most notably defense installations. Even where we must now deal with a lamentable legacy of pollution from such facilities, there is opportunity in the necessity we face of rapidly moving these facilities to economic use by our local communities. In addition we can work with remaining facilities, and with defense industries, to develop innovative pollution prevention techniques that can be rapidly transferred to broader uses;

--our university system, of unmatched excellence;

--and finally, our role as a leader and harbinger of the future is of incalculable benefit. The challenges to our political institutions posed by rapid population growth and technological change will later be felt in other parts of our nation and the world. To the extent that we effectively meet these needs while achieving environmental improvement, our experiences will provide us with a tangible leg up in the increasingly global marketplace.

Permitting and Standards: Need for a New Dialogue

Today I would like to focus on a two key issues for environmental protection: permitting and standard-setting. While these two functions are sometimes melded together in public discussions, it is important to differentiate between them. California has some of the most complex permitting requirements in the world. The two--high standards and lengthy, extremely complex permitting requirements--need not go together.

Our high standards--for air, water, solid and hazardous waste, and pesticides--are the jewels in the crown of California environmental protection. They must be safeguarded. As long as our standards are scientifically based, these standards give us competitive advantages as other jurisdictions, domestically and internationally, approach or adopt our standards. Enterprises with experience meeting these standards can create a market niche either through providing environmental services or through efficiencies achieved in production of products

or services generally. To the extent that our permitting processes assist in achieving our standards expeditiously, they add value to the process. To the extent that permitting imposes costs tangential to, or beyond what is necessary for, achieving our standards, they should be closely examined. The fact that our permitting regime does not appear to be adopted by other jurisdictions, even those which adopt our standards, should remind us of this need.

Our high standards are the jewels in the crown of California's environment.

Environmental Standards and Competitiveness

California's high environmental and energy standards present unparalleled opportunities for private sector performance. As various domestic and international jurisdictions seek to achieve environmental improvement, California is widely recognized to have tremendous economic advantages.

As an example, the London Economist, in a November 1991 article entitled "California Cashes in on Cleaning Up," recognized our head start in the rapidly-growing environmental services sector. The Environmental Business Journal, based in San Diego, provides a regular glimpse of this new industry. The Journal estimates that it exceeds $100 billion per year, with as much as one-quarter based in California. From solid and hazardous waste management, to air, water and pesticides, businesses which serve California are poised to serve the world.

Last autumn, in a striking move, a number of eastern states adopted California auto emissions standards. This winter, California promulgated rules for the reformulation of gasoline. While the rulemaking occasioned controversy because of the great expense involved in refitting refinery capacity, it is striking that one company, Arco, took out advertising praising the rulemaking--recognizing the likely financial benefits that will follow as other jurisdictions look toward fuels reformulated to meet California standards. Another company, Shell Oil, estimates that refitting its refinery capacity to meet the new standard will not only produce cleaner-burning fuel, but also hundreds of construction and permanent refinery jobs. As the world's commitment to reconciliation of the environment and economy continues, and as long as our standard-setting continues to be based upon sound science, export of our standards can precede the export of our products.

It is clear that California experience will be invaluable in meeting many environmental challenges. The cleanup of closing military bases across the United States and Europe will require billions of dollars, and California defense contractors are seeking to meet this need. Computer and satellite technology also has an increasingly important role as environmental protection comes within our working definition of national security. The wanton vandalism of Kuwaiti oil fields by Iraq and the growing evidence of the atmospheric "ozone hole" are harbingers of this change.

As many nations move toward a greater emphasis on environmental protection--from Mexico to the [former] Soviet Union, from east Asia to what we again know as central Europe--a beneficial competition is emerging. California begins in the lead, but leadership must continue to be earned. Other nations see the potential for export of environmental technology and expertise. Japan has announced a 100-year plan for development and export of environmental technology. The European Economic Community, most notably Germany, has also targeted this area for growth. In order to meet this challenge, it is necessary that we maintain our scientifically-based standards, and assure that our permitting procedures reflect the accelerating pace of technological advancement. We must also make certain that California technologies are made known and available not only throughout the state, but aggressively marketed to other states and nations. Governor Wilson stressed this issue in his work with President Salinas and other top government and business leaders in Mexico. President Bush

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made this a key component of the U.S. Mexico Integrated Border Plan recently announced, following his previous establishment of the United States-Asia Environmental Partnership on January 4, 1992.

It is worth noting that the potential business benefits of strong environmental standards are not limited to those providing environmental services. Companies which are leaders in meeting environmental goals are often leaders in quality management as well. Nationally, 3-M Company, Johnson and Johnson, and Monsanto are offered as examples. In California there is leadership in many areas. Among utilities, Pacific Gas and Electric and Southern California Edison are not only making gains in energy efficiency and technology transfer, but are voluntarily committed to 20% reductions in carbon dioxide emissions in the next two decades. A number of businesses, such as IBM, National Semiconductor, FMC and Hewlett-Packard, are reporting dramatic cuts in toxic emissions. As an example of California private sector leadership, the Environmental Business Journal, reports on the dramatic reductions achieved by Caspian, Inc. a metal finishing company in San Diego working primarily in aircraft parts. Since 1987, Caspian has reduced its reported Toxics Release Inventory emissions from 836,000 pounds (placing it as the 55th largest U.S. emitter of carcinogenic air pollutants) to 255 pounds in 1990. This followed a $4 million investment--fully 80% of its net worth--to develop a water-based maskant to replace one containing perchlorethylene. Not only is the new process more environmentally and economically sound, but the maskant is now being marketed to the aerospace industry.

In the coming years, in order to encourage and maintain such progress-and building upon public support for environment protection, especially among the young--environmental leadership will include efforts to provide the public with increasingly useful information. Environmental labelling will continue its evolution into a market signal. The success of public reporting of hazardous emissions in triggering reductions will lead to further refinement of "right to know" laws. Additional extensions of the right to know principle, such as the current debate in England over the standardization of shareholder reports to reflect environmental investment and performance, are important not only in themselves, but also as harbingers of accepted principles of public and private sector environmental accounting.

Permitting and Standards: Need for a New Dialogue

As the reconciliation of economic growth and environmental protection reinforces the value of California's high environmental standards, it also focuses attention on our permitting processes. Let us be clear about our situation: California has achieved very high standards for environmental protection, as well as a permitting regime that is, in aggregate, all too often vexing, unnecessarily burdensome and complex. There is no reason that high standards and permitting delays must go hand-in-hand. Indeed, inordinate permit delays generated by a "puzzle palace" regulatory structure pose a threat to the high environmental standards we all value, in at least two ways. First, by delaying the use of new technologies; second, by threatening public support for environmental protection. Achievement of high, scientifically sound environmental standards is the goal; permitting is the process to meet the goal. Our pursuit of the goal must be unflagging; our willingness to challenge and improve the process must be unremitting.

With this in mind, Cal/EPA has begun a thorough examination of permitting. Following receipt of comments from interested parties across the state, we have initiated a process, starting with internal deliberations, to be followed with extensive public participation. We will

seek the input of people here today, as well as others, aiming toward potential administrative and legislative proposals.

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The examination of permit streamlining raises basic questions of leadership and management. Particularly in this time of rapid economic change, none among us would question the necessity for private enterprises to constantly test and question their practices and procedures, to assure that value is added throughout. Such self-evaluation is no less necessary in the public sector.

In his path-breaking essay, "Entrepreneurship in the Service Institution," Claremont business professor Peter Drucker states that public service institutions "... need to be entrepreneurial and innovative fully as much as any business does." He adds, "The rapid change in today's society, technology, and economy are simultaneously an even greater threat to them and an even greater opportunity." Michael Porter of Harvard Business School, writing about the private sector, explains that "Change is an unnatural act, particularly in successful companies; powerful forces are at work to avoid it at all costs."

Regrettably, the forces against public sector innovation are strong. A common reaction to proposals for innovation is suggest that if it is not "broken," then we should not act to "fix" it--understanding that in the absence of ready measures of "success," procedures may not be considered "broker" until they have altogether lost public confidence.

Drucker, among others, suggests that most innovations in government result from catastrophes. Examples include the reform of the American military in the Theodore Roosevelt administration after the Spanish-American War, and the subsequent post-Vietnam reforms. Where the public enterprise is of unquestioned value, as with environmental protection, awaiting acknowledged catastrophe is altogether unacceptable.

Against that view is the traditional bureaucratic argument that if a process has worked well in the past, it should not be subject to reconsideration today. With benefit of hindsight, we readily recognize that Henry Ford erred in rejecting proposals to use profits from his hugely successful Model T to begin development of a successor. At least that course could be corrected by market signals. Environmental protection procedures that were the essence of leadership at one time must also be subject to reconsideration, particularly in a time when recession combines with international competition to escalate the velocity of change.

Environmental labelling will continue its evolution into a market signal.

Still others may resist--or avoid--innovation for an even more basic reason. As Drucker reports, innovation in the public-service institution may be "resented as an attack on its basic commitment, on the very reason for its existence, and on its beliefs and values." This response is as flawed as it is familiar. As our name says, the mission of Cal/EPA is to protect the environment, not the bureaucracy, for future generations. Our public personnel practices are an enduring legacy of the civil service reform era of more than 100 years ago. Our management organizations for environmental laws were designed over several decades, and have developed in disparate directions. Those urging that existing regulatory and management procedures be viewed as inviolate as our shared environmental goals put both at risk. In safeguarding California's leadership role, that is not a risk we should be prepared to take.

Conclusion

As Governor Wilson has often stressed, not only can the environment and the economy coexist, but they are inextricably linked. The great conservationist Aldo Leopold stated it well: "I am interested in this thing called conservation, because without it our economy will fall

apart." Today one might add that we must focus on economic progress, because without it our environment could be harmed beyond repair.

California stands poised to continue to define environmental leadership in the coming decade. Our environmental commitment holds within it promise of economic progress in a global marketplace. As Professor Porter has written, "... a nation's companies can anticipate global trends if the nation's values are spreading--that is if the country is exporting its values and tastes as well as its products." Our values of market economics and environmental improvement are indeed spreading, and California's opportunity is unmatched.

FOLLOW-UP INTERVIEW

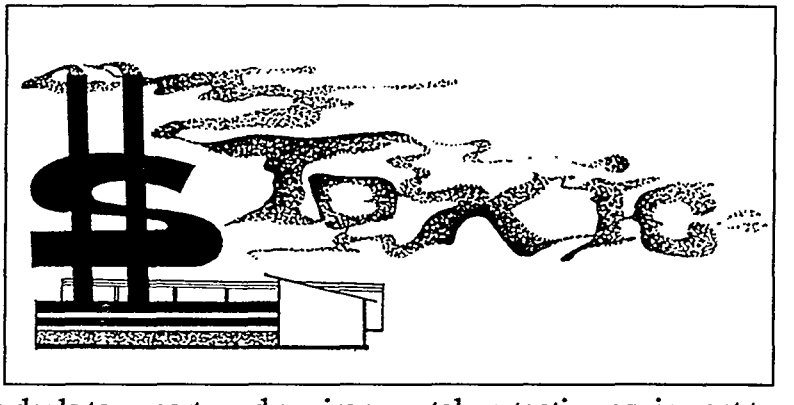
April 14, 1992

Freeman: In your speech you quote a figure of approximately $25 billion in the California Environmental Services sector. Can you compare the size of the current or potential environmental services and technology industries to the cost of compliance for the rest of California's businesses?

Strock: That's a good question. The answer is no. At the present time we don't have accepted measures of the cost of environmental protection in California. We are planning to contract a study to quantify both the costs and the benefits.

Freeman: You mentioned "beneficial competition" internationally in environmental protection technology. Besides providing the motivation to develop the technology, is the State of California doing anything in particular to foster this technological export?

Strock: Yes. That has become a very high priority of the Governor and Cal EPA. I would point to Governor Wilson's recent talks with Mexico's government and business leaders. Also, markets can be created by government action. For example, we try to serve as an information clearinghouse for pollution prevention technology. We stimulate innovative technology through grants and projects. Another significant area in which the state government can make a difference is with procurement projects. Recently California signed on with the United States "Green Lights" project to retrofit public lighting with low energy lights. Such procurement projects serve to promote standardization of innovative technology and demonstrate the technology's benefits.



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Freeman: Recently, an attorney with a major California law firm mentioned to me that her firm is engaged in setting up deals to export used environmental protection equipment to Central European nations. Do you see much potential or progress in this area of technological export?

Strock: Sounds like an excellent idea. All countries must experience different levels of environmental protection as they grow and change. The wealthiest nations have technology similar to ours already. Central Europe will be headed as fast as it can to standards like ours.

Freeman: Also on the international trade aspect, you make note of Japan's "100-year plan for development and export of environmental technology." Is California developing any similar sort of plan?

Strock: We don't have anything specifically like that. We have a different tradition in terms of industrial planning. We are trying to shift our tradition to promote the dialogue that can flow from high environmental standards.

Freeman: The American Lung Association has estimated that air pollution costs the country more than $40 billion annually in medical care and productivity losses. Do you consider the potential reduction of these costs to be central to your view of environmental regulation's benefits to California's economy?

Strock: Yes. That's the reason we plan to focus on a disciplined method of valuing benefits and cost. So that we can move away from the side-tracking debate over methodology and focus on the ultimate point -- environmental protection. It is important for those who are committed to environmental protection to take part in achieving this disciplined quantification.

Freeman: One of the noted direct benefits to business from environmental regulation is an increased efficiency. These efficiencies include energy use, waste (and therefore raw materials use) reduction, and, for the more adaptive businesses, a higher level of quality in management born of the systems analysis attendant on regulation. This make me wonder if perhaps government could also reap these efficiency benefits. I am not speaking of the permitting process reform that you mention in the speech. We can talk about that next. I'm thinking more in internal operational terms. For example: could California take the environmental protection lead in its own business operations by reducing its government vehicle fleet emissions by adopting either alternative fuels or alternative vehicles?

Strock: We are doing that now. The Governor has state fleet vehicles using different kinds of alternative fuels. For example, the car that I drive is fueled by methanol.

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Freeman: In your speech you described the need to consolidate and streamline the permitting process. Your office is pursuing this concept through current proposals for consolidating and streamlining the Cal/EPA Processes. One of the concerns I have heard raised is for the potential loss of public participation in the permit process. A counter to this has been that the process is not really very public anyway. Do you have a response to this debate?

Strock: It is absolutely key for environmental regulation to be extremely public. It is and will be. I don't think there is anything in the proposals that would limit public input. But, it is important to bear in mind that they are proposals. We want input on these proposals. They are a starting point.

Freeman: Michael E. Porter [a Professor at the Harvard Business School] made the observation that true technological innovation will result more from regulations that stress pollution prevention rather than clean up. Does this figure in to your view of regulatory reform?

Strock: Yes. If you have high standards, you get directly at Prof. Porter's point. If these standards are applied prospectively, then they avoid unjustifiably high costs while achieving the environmental protection goal and creating a motivation and market for the technology to get there.

Sheryl Schaffner Freeman is a 2L at King Hall with a keen interest in public interest environmental law.

Freeman: Do you have any parting thoughts to share with us on the fine art of preserving the effectiveness and productive side-effects of California environmental regulation while making the regulatory permit maze more navigable?

Strock: It is important to have the dialogue make clear that environmental standard setting is the key and environmental permitting is a set of procedural mechanisms to meet the standards. The permits are the means and the standards are the ends. These are too often melded into one less effective concept. It is the standards that give us the payoff in terms of environmental protection and the economic benefits we have discussed. It is therefore the standards that are deserving of our protectiveness. We must remain open, however to improving the process of getting those standards attained.