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Linkages between environmental policy, economic growth and employment

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EXTENDED ABSTRACT: Economic growth and employment are key objectives for policymakers in Europe and elsewhere. An important question is therefore how environmental policies affect these macroeconomic variables. This paper reviews the theoretical and empirical literature on linkages between environmental policy and economic performance, in particular economic growth and employment. The relationship between environmental and economic results is highly complex. The Environmental Kuznets Curve posits an inverted-U relationship between economic development and environmental pressure; this suggests that economic growth does not necessarily harm the environment.

Four key linkages from environmental policy to economic performance are discussed in some detail, both with respect to theoretical underpinning and empirical relevance. 1) Externalities or negative spillovers give rise to links between environmental performance and production. 2) Environmental externalities are frequently coupled with innovation externalities and this opening for a broader set of environmental policies and a new linkage between environmental policies and economic performance. 3) The Porter hypothesis argues that environmental policies can help reduce waste in the firms and open new markets with improved economic performance as the result. 4) Structural policies – e.g. market opening – affect the economy but will in many cases also impact the environment.

Assessments of the macroeconomic effects of environmental policies require that the hypothesised link(s) are clearly identified and examined. Both direct and indirect effects must be taken into account. This implies that the general equilibrium effects of environment policies should be considered, i.e. the focus should be on *net* production, *net* employment and the *overall* effect on the environment. The paper underscores the need for thoroughness in the empirical analyses to ensure correct inference. It is important to examine the direction of causality, possible selection biases and the impact of other explanatory variables.

The paper finally underscores that environmental policy should be undertaken to improve economic welfare and not target specific macroeconomic variables like growth or employment. The goal of environmental policies should be to correct market imperfections with the aim to improve social well-being.

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