Can legislation encourage environmental investment by businesses?

The exact impact of environmental law on investment by EU industry is relatively unknown. A new study has explored the effects of regulation on four types of industry investment and the results indicate that, in general, regulation tends to encourage more investment, but if restrictions are too tight investment levels can start to fall.

There are a wide range of views amongst environmental economists as to the impacts of environmental regulation on the behaviour of industry. At one extreme, some argue that firms always seek low costs and will reduce activities under tight environmental standards and/or locate their activities to locations where standards are more moderate. Others argue that firms have a more long-term view and can see the benefits of environmental legislation on the amount of (clean) natural resources and on the demand for innovative technologies. In this latter case, industry will invest more under greater environmental regulation.

In order to gain better insight into this area, the study analysed the impact of greater expenditure on environmental protection and greater environmental taxation on four different industry investment activities. These were: investment in tangible goods, investment in new buildings, investment in machinery, and ‘productive investment’, which is the difference between investment in tangible goods and investment in technologies to reduce environmental impact. This can provide insight into whether changes are mainly driven by investment in technology to abate environmental impact. The data were taken from Eurostat databases from 1998 to 2007 and included 21 countries.

The results indicate that, in general, industry investment is affected by the level of national environmental regulation. On average, a 10 per cent increase in national spending on environmental protection is associated with a 1.3 per cent increase in investment in tangible goods and a 1.5 per cent increase in investment in machinery. The impact on investment in new buildings is somewhat lower with an increase of only 0.6 per cent. A 10 per cent national increase in environmental tax revenues, on average, increased investment by about 1 per cent in tangible goods and machinery, but in new buildings there was an increase in investment of about 2.5 per cent. However, at high levels of environmental expenditure and taxes, i.e. an increase of 90 per cent in spending and taxation, the effects on investment are less positive and at very high levels (99 per cent increase) the effects become negative.

The relationships between environmental regulation and investment indicate that European industries appear to focus on the comparative advantages resulting from an efficient and sustainable resource management, i.e. increased availability of resources (input factors) or enhanced quality due to a decrease in pollution. Alternatively, industry could recognise the advantage of investing in innovative technologies to improve efficiency or to sell technology as a product. Whatever the reason, this relationship does not hold when the costs to comply with regulation are much higher than the benefits. Such insight could help inform policy on the levels to which environmental legislation helps investment and, with further research, it could possibly provide limits of taxation and protection, above which the benefits no longer encourage investment.


Contact: andrea.leiter@uibk.ac.at

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