

## Time to Adopt True Cost Accounting

David A. Bainbridge

*“It is better to be crudely right than precisely wrong”.* Loren T. Neubauer

Most of the environmental problems that now plague us are the result of incomplete accounting for costs. Benefits are concentrated in the hands of a few, and most costs are uncounted and spread across Society and future generations. The brilliant British economist Arthur C. Pigou noted early in the last century that “the market” would fail unless it included all costs; but his message went unheeded. Today most markets and economic calculations are very incomplete and imperfect.

Markets and economists consider only a small subset of the total cost (and value) in most transactions. Neoclassical economists are not troubled by these failures, they rarely even acknowledge their existence in page after page of calculations and functions describing how the economy works, or theoretically should work. Their work falls into the category my mentor Tod Neubauer called “precisely wrong.” It is precise, but environmentally ignorant and socially bankrupt.

If proper accounting is done and full costs are known, many current transactions would not occur, the environment would be much cleaner and safer, we would all be healthier, and we would face a much more hopeful and sustainable future. True costs can be either:

**Internal costs** -- the currently counted costs (production, transport, marketing, overhead, sales, profit) or **External costs** -- the uncounted costs (pollution, health impacts, loss of biodiversity, resource depletion, global warming, etc.) can be local, regional, and global—both current and future.

External costs or externalities can be both public and private. The acknowledged problems are large public externalities such as the health impacts of smoking, alcohol use and air pollution. Less known but also critical are the degradation of ecosystem services and Nature’s capital, including catastrophic losses in fish stocks, loss of function of antibiotics, the risk of diminished biodiversity, social unrest and inequality, and increased pests. The rapidly evolving problems of climate change include increased flooding, wildfires, more severe storms and coastal flooding.

There are also many more local, private externalities where costs are transferred to neighbors, individuals who live downstream or downwind. A good example is the loss of water

from homeowner's wells in the San Joaquin Valley as nut growers suck the aquifer dry and drill ever deeper and more expensive wells.

Most cultural and environmental problems involve both levels of externalities. If these now "external costs" are included in the market (however imperfectly) many of our worst problems would disappear almost overnight. Some external costs are relatively easy to determine and could be added to the transaction cost quickly, others are more difficult to value in dollar terms. Some are difficult because of their nature, but most are difficult to calculate because we have such a limited understanding of the world around us. For example, what is the value of biodiversity? We won't know until we lose it. Others are related to our preferences and beliefs. What is the value of a beautiful view or sunset? We can ask people what they would pay for it – but that is difficult to do for future generations. Who has their proxy vote?

The newly recognized concept of ecosystem goods and services includes many positive economic benefits that are excluded from current markets, social/political decision-making, and investment decisions. These need to be examined carefully to establish benefit values. Street trees for example may provide sound control, air cleaning, health benefits, reduced air conditioning costs, reduced heating costs and carbon sequestration. These benefits can far outweigh the costs of sidewalk damage, damage from falling branches, and maintenance costs. Sustainably managed farms and forests provide many public benefits, oxygen, flood control, water collection, water purification, and carbon sequestration; yet these values are never counted in the profit and loss of a company or government and are missing from GNP calculations.

Costa Rica has recognized these values and provides payments for farmers and foresters. Since 1997, nearly 2.5 million acres of forest in Costa Rica have benefitted. Forest cover has risen to more than 50 per cent from a low of just over 20 per cent in the 1980s.

When the government assumes responsibility for the problems caused by externalities and offers subsidies it further distorts the market. This encourages further bad behavior. It is not enough that the party who caused the problem is not charged; but the victims are often compensated by the victimized taxpayers. Perverse government subsidies and incentives are common and further distort the market.

Far too many government policies reflect the goals of special interests to avoid paying for external costs. The oil depletion allowance is a good example. Rather than paying a depletion fee (for destroying resources that might be irreplaceable and of importance to future generations) oil

producers now often get a tax credit for eliminating resources. It was not always so, for an explanation of how this happened examine to former Senator Bob Dole's career.

It is very easy to say what we should do, simply internalize the externalities; but it is this can be a challenge. The special interests that receive the benefits of incomplete accounting act very quickly to protect their entitlements and freedom from responsibility. The first step needs to be an intensive effort to improve our accounting practices and to develop a much better understanding of how large these costs are and how they are distributed. Many private externalities could be corrected if we did even rudimentary calculations of costs of common impacts and effects. Then the transactions between neighbors, polluters and victims, and communities could be improved through negotiation, mediation and litigation.

The market is never going to be perfect, but it works more efficiently than anything else. True cost accounting can enable governments, companies and people to make better choices and invest more wisely. It gives consumers the information they need to vote for sustainability with every dollar they spend. Ask your legislator today – for the sake of your children and the many generations yet unborn.

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