

THE RIGHT DIRECTION

Some call it hysteria, others say climate policy. Either way, this theme has now taken over the European Union, or vice versa. A "Green Deal" calls for our continent to be carbon neutral by 2050, whatever the cost, which is to say: a lot. One thing is already clear: all this can only be financed with borrowed funds. Particularly in business circles, there are quiet hopes that all the fuss will soon blow over.

The polluter pays principle belongs in a market economy. We have always known that we were environmental free-riders. Now we have the tools to change this – and change it we will.

In my view, however, this is not simply a passing fad, because the issue is not the climate per se. This is simply a reasonably measurable symptom. What is actually at stake is a fundamental, much more vital structural change. The CO₂ problematic, that is, the change in the atmosphere around our planet due to human action or inaction, belongs to a class of phenomena that economists call "*externalities*". These arise when the consequences of human action are not or not entirely borne by the producer, but are passed along to an (unspecified) general public. Exhaust from cars or chimneys of industrial plants are typical instruments for causing externalities. The noxious gases are socialised, distributed to residents near and far.

Whether external costs are internalised – that is, borne by the producer – or not, depends upon the *information and transaction costs* associated with their determination. The later Nobel laureate Ronald Coase demonstrated that the existence of information and transaction costs is ultimately responsible for the creation of externalities. The

result is the tragedy of the commons, their over-exploitation.

Thanks to the extraordinary technological advances of recent years, information and transaction costs have decreased steadily and granularity has deepened to include every combustion engine of even the smallest car. So now, a new equilibrium from an economic point of view must be reached. An equilibrium with significantly *lower external costs*, with much less environmental impact. This has nothing to do with Greta Thunberg, it would have happened in any event. We are still a long way from thoroughly understanding the impact of reducing or even eliminating information and transaction costs on society and the economy. What at first resembles hype and hysteria is just the prelude to a megatrend towards more of the polluter pays principle.

There will be plenty of trials and tribulations (also expensive, stupid ones) along the way. Calls for police-state regulation and collectivisation will drive us to the brink of despair. And future election results will do the same. For now, market economists and liberals will have a difficult time of it. And those who call their wealth their own must be prepared for fiscal raids. Politics is trending green and far left. This will involve heavy costs, and not only in the EU.

Nonetheless, this is the right direction. The polluter pays principle belongs in a market economy. We have always known that we were environmental free-riders. Now we have the tools to change this – and change it we will. What does this mean for investors, for our clients? The most significant changes will take place on the real side – precisely where holders of equities are invested.

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