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## Methods

# K. William Kapp's theory of social costs and environmental policy: Towards political ecological economics

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### ABSTRACT

The paper analyzes the contribution of K. William Kapp, widely considered one of the founders of Ecological Economics. This paper will demonstrate how K. William Kapp developed his theory of social costs into a framework for environmental policy development, i.e. the basis for Political Ecological Economics. The latter provides the most comprehensive and non-utilitarian alternative to the main neoclassical approaches provided by Arthur Pigou and Ronald Coase. Kapp determined basic human needs to be necessary values operational for policymaking via politically derived and scientifically determined social minima (criteria) and socio-ecological indicators. This “rational humanism” was inspired by Weber’s concept of substantive rationality and informed by John Dewey’s pragmatic instrumentalism. The paper concludes that Kapp’s contribution is important enough to cement its place in the broader school of Ecological Economics.

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## 1. Introduction<sup>1</sup>

The paper argues that in the face of increasing socio-ecological disruption in many parts of the world, it is worth re-vitalizing Kapp’s solution to the problem of social costs. Contending that social costs are not inevitable phenomena but depend on the political structure of a society. Kapp developed his environmental policy approach as part of a proposed Political Ecological Economics. This remedy against social costs embodies social minima, maximum tolerance levels, socio-ecological indicators and public controls. The paper shows how this approach is crucially influenced by Kapp’s rational humanism, that is, an adaptation of Max Weber’s concept of “substantive rationality” with John Dewey’s pragmatic instrumentalism.

Thereby, this paper aims to demonstrate that Kapp’s adaptation of the concept of substantive rationality is essential to Political Ecological Economics. So far, the literature usually identifies Karl Polanyi’s distinction between substantive and formal economics as a unifying framework for neo-Marxists and neo-institutionalists, i.e. Institutional Political Economy (O’Hara, 2000, pp. 128–34). The evaluation of the Kapp–Polanyi correspondence shows that Kapp and Polanyi found the core argument for the substantive meaning of the economy in Menger’s ‘two elemental directions of the human economy’, i.e. the ‘technical and the economizing’ (Berger, *in press*). Unlike Kapp, however, Polanyi does not apply Weber’s concept of substantive rationality for political economics.

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First, this paper will introduce Kapp's theory of social costs. Second, it will analyze Weber's definition of substantive rationality and show how this definition inspired Kapp's rational humanism. In particular, Kapp's view of basic human needs as universal values will be discussed because they bear important consequences for Kapp's remedy against social costs, i.e. environmental policy as part of Political Ecological Economics. The latter is not based on exchange values but translates the value of basic human needs into alternative criteria, such as social minima, and maximum tolerance levels that are measured by comprehensive socio-ecological indicators.

## 2. Kapp's theory of social costs

Throughout his life Kapp was concerned about the dehumanization of societal reality resulting from the degradation of the social and ecological environment. "The Social Costs of Private Enterprise" (1950) makes Kapp a pioneer of Ecological Economics not only because it is the first systematic record of social costs but because it presents an alternative to the neoclassical theory of externalities. It is a landmark that shows the practical shortcomings as well as the theoretical inconsistencies of applying the utilitarian principle, i.e. the willingness to pay or to accept compensation, to the evaluation of social costs. Consequently, the significance of Kapp's theory of social costs is that it gives a theoretically sound explanation of the problem of social costs in the tradition of institutional economics and illustrates a practical approach to reducing social costs via environmental policy, outperforming Pigou (1924) and Coase (1960) both in theory and applicability. Unfortunately, Coase's famous article "The Problem of Social Costs" ignores Kapp's contribution, that was well known at the time and had been translated into several languages. The second enlarged and revised edition "The Social Costs of Business Enterprise" (1963a) was published in India, where Kapp was working at the time, and was difficult to obtain.

Kapp defined social costs as "all direct and indirect losses sustained by third persons or the general public as a result of unrestrained economic activities. These social losses may take the form of damages to human health; they may find their expression in the destruction or deterioration of property values and the premature depletion of natural wealth; they may also be evidenced in an impairment of less tangible values." (Kapp, [1963a] 1977, p. 13) Importantly, to classify as social costs the damages must be avoidable (Kapp, [1950], [1963a] 1977, p. 14) so that Kapp's definition does not go against the entropy law of which he was aware since 1961 (Kapp, 1961, p. 93), referencing Georgescu-Roegen since the 1970s.

Kapp's theory shows that social costs are to a large extent a non-market phenomenon because the relations between production, the environment, and the individual, are not voluntary market relations, but involuntary one-sided relationships forced on the individual. The individual cannot escape them and they happen "behind his back". Due to asymmetric power relations, the bearers of social costs are usually too weak to defend themselves against this cost shifting; specifically, "[w]henver social costs are shifted onto economically and politically weaker sections of society without compensation, a redistribution of the costs of production, hence real income is

involved." (Kapp, 1972a, p. 16) Kapp pointed out that the co-existence of a public and private sector with its combination of public and private controls makes it necessary to define social costs as damages and harmful effects of public and private economic decision making (Kapp, [1965a] 1983, p. 10).

## 3. Weber's concept of formal rationality

According to Kapp, social costs reflect above all a misallocation of resources resulting from an institutionalized economic calculus that induces economic units to take inadequate account of harmful environmental effects of their investment and production decisions. Kapp used Weber's definition of formal rationality to explain that the problem of social costs in a market economy results from an economic calculus based on market values that "are numerical and quantitative. As such, they can be added and compared in terms of operations which are simple and easily understood. [...] their numerical character [...] enables us to compare and measure them unambiguously in the formal sense of all mathematical operations [...]" (Kapp, 1963b, p. 189). The shallow simplicity of these values in effect functions like a decision rule, according to which allocation decisions are made. The business unit's decision-making process is highly structured and consists of the mobilization and choice of physical and real means. This result in the selection of the technique evaluated to maximize expected returns in terms of market costs, but without consideration of any impact on the quality of the physical and social environment (Kapp, [1971a] 1983, p. 118).

Weber had defined a system of economic activity as "formally rational" to the degree in which the provisioning for needs is expressed or accounted for in numerical terms. This form is based on money units in a market economy, i.e. market value, or accounting in natural units. Weber also mentions the material conditions (real societal circumstances) that underlie formal rationality, such as power struggles, and differences in purchasing power. Weber distinguished formal rationality (formale Rationalität) from substantive rationality (materiale Rationalität) and applied them in the discussion about socialist accounting. Weber considered Otto v. Neurath's theory of an accounting in natural units (Naturalrechnung) as an alternative to accounting in money units, although the former is also formally rational and subject to limitations (Weber, [1925] 2005, pp. 60–1, pp. 77–8; Weber, 1947, pp. 184–6, p. 211). Already in his dissertation "Planwirtschaft und Aussenhandel" (1936) Kapp critiqued the economic calculus in terms of market prices and concluded the impossibility of reaching efficiency viewed from society (Wirtschaftlichkeit vom Standpunkt der Gesellschaft) on the basis of an economic calculus in terms of market prices (Kapp, 1936, p. 35–46). In this work Kapp referred to Carl Menger's second edition of the *Grundsätze* that had criticized market-price-based accounting for its failure to account for and consider the needs of those members of society who lacked purchasing power and could not participate in market transactions. (Kapp, 1936, p. 37; Menger, 1923, p. 49) Kapp quoted the following passage from the chapter on "social exigencies" in the *Grundsätze*: "the latter [the business community] consider the smallest desire of individuals with purchasing

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