The Influence of Financial Status on Environmental Performance: 
The Role of Enforcement

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Abstract

This paper analyzes the link from financial status to the environmental performance generated by individual polluting facilities, while addressing the role that enforcement plays in shaping this link. The analysis considers multiple dimensions of both financial status and enforcement. Regarding corporate financial status, the paper considers measures of liquidity, solvency, and profitability [a proxy for corporate managerial skill], all of which can influence the likelihood that a firm faces liquidity and/or bankruptcy constraints. Regarding enforcement, the paper considers both the likelihood of enforcement, as captured by the likelihood of inspections conducted at regulated facilities, and the severity of enforcement, as captured by the size of sanctions imposed on polluting facilities found violating their effluent limits. The paper first develops a theoretical model of optimal abatement in the presence of liquidity and bankruptcy constraints and uses the model to investigate the impact of financial status on optimal abatement and to explore how enforcement shapes this impact. Then the paper empirically examines the interactions between financial status and enforcement using data on wastewater discharges from US chemical manufacturing facilities for the years 1995 to 2001. Empirical results suggest that enforcement in general plays an important role in shaping the effects of financial status on environmental performance.

(joint with Kathleen Segerson)