Pollution Regulation under Imperfect Competition

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Abstract:
Opponents of pollution regulation claim that regulations choke businesses, hurt welfare and destroy economic growth. Do pollution regulations in fact hurt producers and the economy? To address this question, we develop an integrated production-pollution-abatement model, and study two popular regulations—Cap-and-Trade and Taxes—under imperfect competition. We show that firms' strategic tradeoffs between output reduction and pollution abatement, not identified in the prior literature, drive industry profits, consumer surplus and welfare. Moreover, the market structure mediates these tradeoffs, and is thus an important, if overlooked, driver of the economic consequences of pollution regulation. We prove that under imperfect competition, well-chosen regulation improves firms' profits compared to laissez-faire, and can often, simultaneously, improve consumer surplus and welfare. Our results suggest that the paramount factor in framing pollution regulations should be their impact on consumers rather than on producers.

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All Interested are Welcome