Introduction

Two basic theories of regulation:

1. Public Interest Theory
2. Interest Group Theory

Traditional normative Justification for government regulation

1. Imperfect Competition
2. Imperfect Information
3. Provision of —
Figure 8.1 Schematic of interactions among government, polluting firms, and consumer citizens.
The key features:

- Restricted choice for the polluters as to what means will be used to achieve an appropriate environment target
- A lack of mechanisms for equalizing marginal control cost among several different polluters

Advantages:

- More flexibility in regulating complex environmental process
- Certainty in how much pollution will result from regulation
- Simplifying monitoring of compliance with a regulation

Disadvantages:

- Informational costs are high
- Polluter has incentives to distort information provided to the regulator
- Is difficult to satisfy the equimarginal principle
• Pollution Fees: the payment of a charge per unit of pollution emitted
• Marketable permit: allows polluters to buy and sell the right to pollute
• Liability: If you harm someone, you must compensate that person for damage

\[ MC(X^*) = -MD(X^*) \]
Regulating Pollution
Economic Incentives

- Advantage: Equimarginal Principle
- Disadvantage:
  - Developing Economic Incentives that take into account the complexities is difficult
  - There is a great deal of uncertainty associated with the environmental problem being controlled.
How best can regulations be structured for the case in which we cannot observe emissions?

How best can regulations be structured to give polluters incentives to act efficiently and truthfully divulge information necessary for regulation?

How can enforcement policies be designed to give polluters incentives to obey regulations?