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AN EFFICIENT MECHANISM TO CONTROL CORRELATED EXTERNALITIES: REDISTRIBUTIVE TRANSFERS AND THE COEXISTENCE OF REGIONAL AND GLOBAL POLLUTION PERMIT MARKETS

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ABSTRACT

We compare tradable permit markets and emission taxes as self-enforcing mechanisms to control correlated externality problems. By "correlated" we mean multiple pollutants that are jointly produced by a single source but which simultaneously cause differentiated regional and global externalities (e.g., smog and global warming). By "self-enforcing" we mean mechanisms that account for the endogeneity that exists between competing jurisdictions in the setting of environmental policy within a federation of regions. We find that joint domestic and international permit markets are Pareto efficient, while joint emissions taxes are not.

JEL classification: C72, D62, D78, H41, H77, Q28.