

Location-dependent payments From households To polluting firms

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Abstract

We present a model where households and polluting firms can choose from two locations(A and B). Households incur environmental damage from firms in the same location. Under laissez faire, payments from households in one location (say A) to firms in the other location (say B) will prompt firms to move from A to B and to stay there, thus reducing damage to households in A.

A necessary condition for these payments is that households prefer A to B. When payments start from a laissez-faire evolutionary equilibrium (where nobody is inclined to move), the payment equilibrium may feature too many firms in A. Thus the Coase theorem does not necessarily apply. When the payments start while firms and households are still moving between locations, they might set society on the path to a completely different and new equilibrium.

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