

# Carbon leakage: a mechanism design approach

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## Abstract

Should firms be offered compensations for accepting regulations? Firms threatening to relocate press policy makers to consider compensations but their relevance for staying is private information. We develop a mechanism design approach to the problem. The mechanism uses exclusion (positive leakage) and the intensity of regulation as screening devices to save on public funds and to allocate the regulatory assignments efficiently. Positive leakage is optimal and the intensity of regulation can be stronger than in the first best. Industries are treated very differently, depending on moving and compliance costs. We draw particular lessons for local regulation of global climate externalities.

Keywords: Carbon leakage, emissions trading, private information, climate change, unilateral climate policies, mechanism design.

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