

# A Simple Compliance-Inducing Mechanism for Pollution Regulation

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In this paper we propose a simple signaling game structure that will make the EPA's monitoring of polluting firms more effective. When the EPA is constrained in policy instruments and has limited enforcement budgets, the task of emission monitoring can only be carried out incompletely. With the help of our simple design, it will be able to distinguish between complying and non-complying firms. No inspection is to be wasted on the complying ones any more. As a result, in equilibrium more firms become compliant, and even persistent polluters will reduce their emissions.

In addition, we demonstrate that further gains can be had if the common practice of self-reporting is combined with our design. In our model, there are benefits to the society, as total pollution emissions decline. There are also gains to the government since more tax revenues will be generated in the monitoring process.

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