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- A differential oligopoly game is proposed, where firms exploit a renewable resource and emit CO<sub>2</sub> causing global warming.
- The public authority regulates access to the commons to attain the maximum sustainable yield and taxes emissions.
- Regulating access implies that, if firms invest in emission abatement, the tax can be used to annihilate emissions and the associated damage.
- This involves a win-win solution confirming the strong form of the Porter hypothesis.
- We also extend the model to encompass product differentiation and monopolistic competition.

Journal Pre-proof

# Managing the tragedy of commons and polluting emissions: a unified view\*

Gustav Feichtinger\*, Luca Lambertini<sup>§</sup>,  
George Leitmann<sup>#</sup> and Stefan Wrzaczek<sup>§</sup>

★ Institute of Statistics and Mathematical Methods in Economics  
TU Wien, Vienna, Austria; gustav.feichtinger@tuwien.ac.at

§ Department of Economics and Alma Climate Research Institute,  
University of Bologna, Bologna, Italy; luca.lambertini@unibo.it

# College of Engineering, University of California at Berkeley, Berkeley, CA; gleit@berkeley.edu

§ International Institute for Applied Systems Analysis (IIASA)  
Laxenburg, Austria; wrzaczek@iiasa.ac.at

## Abstract

We address the issue of regulating both polluting emissions through a generic tax and access to a common resource pool in a dynamic oligopoly game. Our analysis shows that once industry structure is regulated so as to induce the industry to harvest the resource in correspondence of the maximum sustainable yield, social welfare is either independent or decreasing in the tax if firms do not invest in abatement technologies, while, if they do, the policy maker may increase the tax to foster both individual and aggregate green research and development to attain abatement technologies, ideally up to the level at which emissions and the associated environmental damage are nil. This also allows us to detect the arising of the win-win solution associated to the strong form of the Porter hypothesis. We extend the analysis to encompass product differentiation and monopolistic competition, to show that qualitatively analogous conclusions obtain.

**Keywords:** OR in environment and climate change; sustainability; differential games; green research and development; Porter hypothesis

## 1 Introduction

The analysis of natural resource extraction is, most frequently, disjoint from the analysis of global warming as a result of anthropic activities. Yet, there obviously exists an intimate connection be-

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tween the two, irrespective of whether the resources at stake are renewable ones or not, as producing final consumption goods involves both, and production and consumption jointly contribute to the accumulation of polluting emissions. The terms (polluting) emissions and pollution in our paper correspond to  $CO_2$ -equivalent (i.e., greenhouse gas) emissions. Indeed, there exists a relatively small literature including a few notable contributions which have proposed a joint analysis of renewable resource and pollution dynamics in optimal control models sometimes accommodating also endogenous growth (see Tahvonen, 1991; Tahvonen and Kuuluvainen, 1991, 1993; Ayong Le Kama, 2001; and Wirl, 2004). All of these focus on the assumptions of (i) a representative consumer either autonomous or flanked by a policy maker, and (ii) a perfectly competitive economic system

However, the global economy is supplied by industrial sectors populated by large firms endowed with non-negligible degrees of market power. Accordingly, it is appropriate to deal with this problem from a standpoint whose flavour is typically associated with the theory of the firm and operations research, encompassing though the policy stance inherently belonging to the aforementioned view. This overlapping between OR, industrial organization and environmental policies is already organic to a growing literature where static and dynamic oligopoly models in which firms may be vertically integrated or not.<sup>1</sup> A notable contribution reconciling macroeconomics, resource economics and operations research, which has appeared in this Journal, is in Wu *et al.* (2018). They propose a unified approach to the study of economic growth encompassing the regenerative capacity of natural resources, showing that the arising of externalities across different regions may give rise to a prisoner's dilemma jeopardising welfare and resource preservation. Their model nests a game among regions or countries concerning resource exploitation and capital accumulation into an endogenous growth model with perfectly competitive markets.

From an analogous although not identical standpoint, we believe that a dynamic game encompassing the dynamics of pollution and that of natural resources facing the impact of firms exploiting them to supply the global market should be part of the research agenda, and possibly at the top of it. On the basis of these considerations, we propose a comprehensive view of the impact of an oligopolistic industry on a renewable resource used to produce consumption goods implying polluting emissions, complemented by a policy analysis.

To this purpose, we will illustrate a differential oligopoly game in which the linear dynamics of polluting emissions<sup>2</sup> combines with the logistic growth of a renewable resource as in the VLV

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<sup>1</sup>Confining our attention to recent contributions appearing in this Journal, see, among many others, Yenipazarly (2016) on the impact of emission taxes and tradeable permits on remanufacturing; Bia and Zhao (2020) on the interplay between emission taxation and abatement subsidies on the sustainability of supply chains; Jung and Feng (2020) on the effects on industry dynamics exerted by public subsidies stimulating investments in green technologies; and Jin *et al.* (2021) on consumer environmental awareness.

<sup>2</sup>This the same appearing, e.g., in Benckroun and Long (1998) and uncountably many others. For an overview of

model (Verhulst, 1838; Lotka, 1925; Volterra, 1931). In this respect, it is worth adding that several recent developments of the debate about the economic exploitation of renewables have relied on either a piecewise linear ('tent-shaped') or simply a linear approximation of the logistic growth function appearing in the VLV setup.<sup>3</sup> These approaches, which have delivered a large spectrum of valuable results, among which a detailed analysis of the continuum of feedback strategies and the arising of voracity, either disregard the maximum sustainable yield altogether, because it does not exist if the population dynamics is linear, or transform it in a non-differentiable point in the piecewise linear case.

This paper builds upon the extension of the VLV model investigated in Lambertini and Leitmann (2019). There, it is illustrated that, the nonlinear dynamics of the renewable resource notwithstanding, the differential oligopoly game of resource extraction yields a subgame perfect (or strongly time consistent) equilibrium under open-loop information, in correspondence of which the policy maker may regulate access to the common pool resource in such a way to induce the industry to locate itself arbitrarily close to the maximum sustainable yield, ensuring thus a sustainable exploitation path in the long run. In this respect, our analysis is connected with the debate about the optimal industry structure (i.e., the number of firms) in the commons (see, *inter alia*, Cornes *et al.*, 1986; Mason *et al.*, 1988; and Mason and Polasky, 1997). This result also holds in the perfectly competitive case, where the exogenous market price delivered by an infinitely elastic demand becomes an additional regulatory tool in the hands of the public authority in order to achieve the desired outcome. However, it should be stressed that regulating access to commons, no matter how attractive and promising it is, remains a problematic issue which lends itself to be properly solved on theoretical grounds while falling short of its ideal targets in many real-world circumstances (see, e.g., the debate about international fishing agreements in Munro, 1990; and Pintassilgo *et al.*, 2010, among others).

Here, we expand the model to account for the environmental impact of production and/or consumption of the related final good, and the analysis of the equilibrium welfare involving profits, consumer surplus and the environmental balance consisting of the residual resource stock and the convex environmental damage caused by polluting emissions. To complete the picture, we admit the presence of an emission tax and consider the possibility for firms to invest in green research and development (R&D henceforth) efforts for emission abatement.

A few remarks are in order concerning the use of the emission tax by the regulator. As is well known, under imperfect competition the efficient tax does not induce firms to exactly internalise the marginal environmental damage, due to the presence of extraprofits and consumer surplus. That is, any demand

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the related literature, see Lambertini (2013, ch. 8, and 2017, ch. 7).

<sup>3</sup>Models of the first type appear in Benckroun (2003, 2008), Colombo and Labrecciosa (2013a, 2015) and Benckroun and Long (2016), while some of those belonging to the second can be found in Fujiwara (2008), Colombo and Labrecciosa (2013b) and Lambertini and Mantovani (2014, 2016).

function less than perfectly elastic poses a serious problem to the authority because maximising welfare is not equivalent to fully internalising the externality. Indeed, Buchanan (1969) and Barnett (1980) have shown that the welfare-maximising tax falls short of the marginal environmental damage in monopoly, and the same happens, in general, under oligopolistic behaviour (see Simpson, 1995; and Katsoulacos and Xepapadeas, 1995), with few exceptions emerging under cost asymmetries across firms and in correspondence of the limit properties of the free entry equilibrium. The fact is, in brief, that using emission taxation to maximise welfare leads, more often than not, to a compromise driven by the well known tradeoff between consumer and producer surplus on one side and the environmental balance on the other.

Our approach offers a new perspective about this long standing issue, as, instead, we discover that regulating entry to drive industry harvest in correspondence of the maximum sustainable yield partially or completely sterilises tax policy (if firms only react through output) or allows the authority to use the tax in order to increase (indeed, maximise) the greenness of technology (if firms implement R&D project under the stimulus provided by the emission tax itself). The intuition behind this result is that regulating access to the commons in order to achieve harvesting at the maximum sustainable yield amounts to regulating individual and total output, thereby disconnecting the tax from the remaining part of the environmental balance, namely, the damage caused by emissions. All of this is proved keeping the model as general as possible, and specifying only the essential qualitative properties of the building blocks, such as market demand, production costs, a convex damage function, and the system of differential equations governing the renewable resource and firms' emissions.

Then, we revert to a fully specified setup through which these results are generated by augmenting in several directions the basic model, which initially accounts for a Cournot industry supplying a homogeneous good produced at constant returns to scale through the extraction of a renewable resource. The basic layout indeed implies that regulating access to attain harvesting at the maximum sustainable yield fully sterilises the emission tax, whose only effect is purely redistributive. As soon as one admits the presence of (i) decreasing returns, (ii) product differentiation and (iii) R&D for emission abatement, the scenario engendered by the model changes significantly. In particular, adding R&D investments to the initial version of the model suffices to yield the most relevant insight this paper offers, since in this case aggregate R&D efforts increase monotonically in the tax and the regulator may use it to decrease both emissions and the resulting environmental damage. Furthermore, (i) there exists a unique emission tax at which emissions and the damage are nil and still profits and consumer surplus are strictly positive; and (ii) this tax rate exceeds the welfare-maximising tax.

The resulting tradeoff posed to the policy maker prompts a verification of the Porter hypothesis

(Porter, 1991; Porter and van der Linde, 1995)<sup>4</sup> in its strong form, according to which firms subject to environmental regulation react by going green, which delivers a win-win solution whereby industry profits go up together with social welfare. Indeed, we prove this holds true by comparing the equilibrium profit and welfare levels across the first two settings just mentioned. The tradeoff between welfare and greenness disappears once R&D investments are just high enough to reduce emissions to zero, because emission taxation disappears as well. Note that, a further positive effect of reducing  $CO_2$  emissions (strengthening the win-win situation) is the conservation of biodiversity. This has been moved into the center of interest over the last years (cf., Wintle *et al.*, 2011 and Warren *et al.*, 2013), while it is not explicitly accounted for in the debate about the Porter hypothesis. In this respect, our analysis suggests that resource preservation and climate action could be jointly included inside the perimeter of the Porter hypothesis.

Analogous considerations also apply in correspondence of the equilibrium outcome of the differential game associated with the full model in which firms offer differentiated varieties and operate under decreasing returns to scale, as well as in the alternative scenario in which, all else equal, we assume the presence of monopolistic competition.

The remainder of the paper is structured as follows. Section 2 illustrates the layout of the model in its general version, to derive the main results independently of specific assumptions concerning demand, cost and damage functions, and also discusses the implications of the Ramsey rule, which disappears as soon as one focusses upon the degenerate feedback solution under open-loop information. The specialised oligopoly game with product homogeneity and constant returns to scale is in section 3, while further extensions to decreasing returns, product differentiation and monopolistic competition are in section 4. Section 5 contains a few concluding remarks and briefly indicates avenues for future research.

## 2 Resource extraction and polluting emissions

Consider a market existing over continuous time  $t \in [0, \infty)$ , being supplied by  $n \geq 1$  identical firms exploiting a renewable resource  $X(t)$  to produce a homogeneous final good sold to consumers. The dynamics of the natural resource is as in the VLV model,

$$\dot{X}(t) = \delta X(t) [1 - \beta X(t)] - \gamma Q(t) \quad (1)$$

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<sup>4</sup>The stream of theoretical and empirical research on the Porter hypothesis is too large to be accounted for comprehensively here (for exhaustive overviews, see Lanoie *et al.* 2011, Ambec *et al.*, 2013, and Lambertini, 2017). To the best of our knowledge, the only dynamic model in this vein is that of Xepapadeas and de Zeeuw (1999), where firms change their capital stocks under the stimulus exerted by emission taxation.

in which  $\beta$ ,  $\gamma$  and  $\delta$  are positive constants, and  $Q(t) = \sum_{i=1}^n q_i(t)$  is the sum of the  $n$  firms' individual harvest at any time  $t$ . Through an appropriate choice of measure,  $q_i(t)$  and  $Q(t)$  are also the instantaneous individual and industry output levels.

Production and/or consumption are responsible of polluting emissions, whose total amount at any instant is  $S(t) = \sum_{i=1}^n s_i(t)$ ,  $s_i(t)$  being the emission level imputed to  $q_i(t)$ , in such a way that we have  $n$  additional state equations of the following form:

$$\dot{s}_i(t) = \nu q_i(t) - \eta s_i(t) \quad (2)$$

where  $\nu$  and  $\eta$  are positive constants. Before proceeding any further, a few words are appropriate to justify this choice, which excludes the double commons case. Indeed, we could have modelled the latter by stipulating the existence of a single state  $S(t)$  being determined by the production/consumption of industry output  $Q(t)$ , in such a way that firms should account for a single state equation  $\dot{S}(t) = \nu \sum_{i=1}^n q_i(t) - \eta S(t)$ . Accordingly, firms would then be subject to a taxation levied on  $S(t)$ . Indeed, this choice would replicate the qualitative nature of our main results, with a *caveat* related to the role of green R&D, which would appear in the pollution dynamics as a public good, since the contribution of any single firm in terms of emission abatement would alleviate the tax burden borne by all firms alike. This would thus give rise to a scenario which would not be adherent to casual observation of firms' behaviour. A brief sketch of this alternative formulation of the problem, confined to the linear Cournot model, is in appendix A.1.

Back to our model, the first scenario envisages Cournot competition with homogeneous goods. Accordingly, we assume that, at any  $t$ , firms face a single inverse demand function  $p(Q(t))$ , with  $\partial p(Q(t))/\partial Q(t) < 0$  and  $\partial^2 p(Q(t))/\partial Q^2(t) \geq 0$  (the latter condition ensures concavity of instantaneous profits, see Dixit, 1986). Moreover, firms share the same technology summarised by a cost function  $C_i(q_i(t))$ , with  $\partial C_i(q_i(t))/\partial q_i(t) > 0$  and  $\partial^2 C_i(q_i(t))/\partial q_i^2(t) \geq 0$ , i.e., marginal cost is non-decreasing. Then, the regulator imposes a tax levied on each individual firm's emissions, in such a way that the instantaneous profit function of firm  $i$  is  $\pi_i(t) = p(Q(t))q_i(t) - C_i(q_i(t)) - \tau s_i(t)$ .

Firm  $i$  has choose harvest  $q_i(t)$  so as to maximise the discounted profit flow  $\Pi_i(t) = \int_0^\infty \pi_i(t) e^{-\rho t} dt$  under the constraint posed by (1). The Hamiltonian function of firm  $i$  is therefore

$$\begin{aligned} \mathcal{H}_i(t) = & p(Q(t))q_i(t) - C_i(q_i(t)) - \tau s_i(t) + \lambda_{ii}(t)[\nu q_i(t) - \eta s_i(t)] \\ & + \sum_{j \neq i} \lambda_{ij}(t)[\nu q_j(t) - \eta s_j(t)] + \mu_i(t)[\delta X(t)(1 - \beta X(t)) - \gamma Q(t)] \end{aligned} \quad (3)$$

to be maximised w.r.t.  $q_i(t)$ , the initial conditions being  $X_0 = X(0) > 0$  and  $s_{i0} = s_i(0) \geq 0$  for all  $i = 1, 2, \dots, n$ .

Suppose firms operate under open-loop information. The first order condition (FOC) taken w.r.t.  $q_i$  is (henceforth, we omit the explicit indication of the time argument):

$$\frac{\partial \mathcal{H}_i}{\partial q_i} = \frac{\partial \pi_i}{\partial q_i} + \lambda_{ii} \nu - \mu_i \gamma = 0. \quad (4)$$

To ease the exposition of the ensuing discussion, we may reformulate the profit function as  $\pi_i = \tilde{\pi}_i - \tau s_i$ , where  $\tilde{\pi}_i = p(Q) q_i - C_i(q_i)$  is the instantaneous profit function in the absence of taxation. This allows us to rewrite the above FOC as follows:

$$\frac{\partial \mathcal{H}_i}{\partial q_i} = \frac{\partial \tilde{\pi}_i}{\partial q_i} + \lambda_{ii} \nu - \mu_i \gamma = 0 \quad (5)$$

since only gross profits are involved in the choice of  $q_i$ .

The associated system of the  $n + 1$  costate equations is

$$\dot{\lambda}_{ii} = (\eta + \rho) \lambda_{ii} + \tau \quad (6)$$

$$\dot{\lambda}_{ij} = (\eta + \rho) \lambda_{ij}, \quad \forall j \neq i \quad (7)$$

$$\dot{\mu}_i = [\delta (2\beta X - 1) + \rho] \mu_i \quad (8)$$

This implies that the costate dynamics associated with  $\lambda_{ij}$  and  $\mu_i$  is described by a differential equation in separable variables, admitting the solutions  $\lambda_{ij} = 0$  and  $\mu_i = 0$  at all times.<sup>5</sup> This is not true for  $\lambda_{ii}$  except in the special case in which  $\tau = 0$ , i.e., if emission taxation is permanently absent. However, the game is linear in the vector  $s = (s_1, s_2, \dots, s_n)$  of emissions, and state-redundant w.r.t. the resource stock  $X$ . These two properties imply that the open-loop solution of the game is indeed subgame perfect (or, strongly time consistent), although the structure of the game is not linear in one of the state variables (cf., Dockner *et al.*, 2000).<sup>6</sup>

Before proceeding with the discussion of the solution of the oligopoly game, it is useful to define the welfare function, as follows:<sup>7</sup>

$$SW = \sum_{i=1}^n \pi_i + CS + TI - D + X \quad (9)$$

in which  $CS = \int_0^{Q^{CN}} p(Q) dQ$  is consumer surplus, amounting to the integral of the demand function up to the Cournot-Nash industry output  $Q^{CN}$ ;  $TI = \tau S = \tau \sum_{i=1}^n s_i$  is the income generated by

<sup>5</sup>Both  $\lambda_{ij} = 0$  and  $\mu_i = 0$  mean that firm  $i$  does not include the corresponding state variable in the own optimization nexus. In comparing the non-cooperative solution with the socially optimal one, this totally myopic attitude opens an important channel to be exploited by the public authority implementing taxes.

<sup>6</sup>This property of the VLV model was originally pointed out by Goh *et al.* (1974). See also Leitmann (1973).

<sup>7</sup>This definition of the welfare function accounts for the combination of industry profits, consumer surplus and the *environmental balance*  $X - D$ . This formulation captures the nature of the problem posed to the policy maker, which may face a tradeoff between the traditional components of welfare and the environmental ones. The expression in (9) appears in too many contributions to list them all here, but see, *inter alia*, Lambertini (2013).

emission taxation, which is redistributed to society (for example, in the form of infrastructures and public services); and  $D = \zeta S^2$  is the environmental damage, convex in aggregate emissions. The definition of  $SW$  in (9) applies at all times, as well as in steady state.

The simultaneous presence of consumer surplus and the environmental damage raises the issue of intergenerational equity. In our model we assume that the population consists of a representative individual or group living forever unaltered. The population (or different generations thereof) is not modeled separately and would imply an additional complication. This is the focus of Wrzaczek *et al.* (2014) and Wrzaczek (2021), who consider a continuous OLG structure of the population. Wrzaczek *et al.* (2014) derive a time consistent tax scheme on individual emissions driving individually optimal emissions to coincide to socially optimal ones. Wrzaczek (2021) demonstrates that under the possible threat of a catastrophic climate change the non-cooperative outcome cannot replicate the cooperative one if not all individuals actively anticipate this climate change. In contrast to our model, which focuses on the firm's side, the aforementioned papers concentrate on the citizens' side of the problem.

## 2.1 The degenerate feedback solution

The solution of the Hamiltonian problem (3) with  $\mu_i \neq 0$  generates a Ramsey rule governing the economic exploitation of the natural resource, as is well known since Gordon (1954), Smith (1969), Clark (1975), Peterson and Fisher (1977), Berck and Perlo (1984), Clark (1990) and many others. The main difference between these contributions and ours is that we specify the harvesting strategy as a quantity while in the aforementioned references the harvest is in fact a production function defined in terms of the stock and a labour input, which typically implies multiple equilibria at the intersection between the resulting harvest curve and the concave locus describing the reproduction rate of the stock.<sup>8</sup> Conversely, in our approach, firms explicitly view the harvest as a product which they want to sell to consumers along the market demand. This implies a myopic attitude on the part of firms, which may actually turn out to help the regulator.

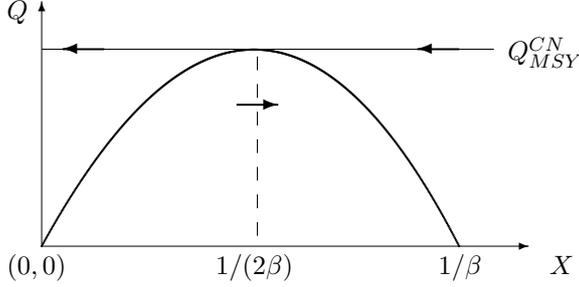
In order to draw the consequences of firms' shortsightedness, we outline the equilibrium of the game engendered by posing  $\lambda_{ij} = 0$  and  $\mu_i = 0$  at all times, to infer a key property of the model. Recalling the main result in Lambertini and Leitmann (2019), concerning the possibility for the authority to regulate access to the commons to force the industry to harvest in correspondence of the  $MSY$ , we may conclude that (i) if indeed the authority grants access to a specific number of firms,  $n_{MSY}(\tau)$ , accounting for the presence of the emission tax, then the industry output  $Q_{MSY}^{CN}(n_{MSY}(\tau))$  is indeed 'fixed' to ensure the attainment of the  $MSY$  at any time, as in Figure 1 (which corresponds to Figure

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<sup>8</sup>An alternative but largely analogous approach underpins the poach-and-trade model in Damania and Bulte (2007), where agents solve a static game delivering the optimal strategies which, unlike what happens in the present model, are determined by a Schaefer production function.

3 in Lambertini and Leitmann, 2019, p. 4), where the arrows illustrate the fact that the tangency solution at the *MSY* is semi-stable.

**Figure 1** Harvesting at the *MSY*



Firms solve (5) to find the optimal individual quantity and then also its control equation. Moreover, again from (5), we have the expression of the shadow value attached by firm  $i$  to its own emissions,  $\lambda_{ii} = \frac{1}{\nu} \frac{\partial \tilde{\pi}_i}{\partial q_i}$ , which can be differentiated w.r.t. time to obtain  $\dot{\lambda}_{ii} = \frac{d\tilde{\pi}'/dt}{\nu}$ , where  $d\tilde{\pi}'/dt \equiv d(\partial \tilde{\pi}_i / \partial q_i) / dt$ . The r.h.s. of the above expression must be equal to the r.h.s. of (6), and consequently the expression of the optimal shadow value is  $\lambda_{ii} = (d\tilde{\pi}'/dt + \nu\tau) / [\nu(\eta + \rho)]$ , which in turn implies that increasing the tax pressure will decrease individual and industry optimal outputs, respectively defined as  $q^{CN}(n, \tau)$  and  $Q^{CN}(n, \tau)$  at any time, and of course in steady state.

Now the matter is that the regulator wants firms to harvest at the *MSY* at all times to preserve the biological stock forever, and therefore we may plug  $X = 1/(2\beta)$  into (1) and then impose  $n = n_{MSY}(\tau)$  in such a way that  $Q_{MSY}^{CN} = \delta/(4\beta\gamma)$ . Here it is worth noting that this number of firms will necessarily be increasing in  $\tau$ , i.e.,  $\partial n_{MSY}(\tau) / \partial \tau > 0$  in order to keep  $Q_{MSY}^{CN}$  constant, since, as noted above,  $q^{CN}(n, \tau)$  and  $Q^{CN}(n, \tau)$  are necessarily decreasing in  $\tau$ .

The discussion carried out thus far also implies that consumer surplus  $C_{MSY}^{CN} = (Q_{MSY}^{CN})^2/2$  and the steady state amount of emissions  $S_{MSY}^{CN} = \nu Q_{MSY}^{CN}/\eta$  are independent of the emission tax, and so is the environmental damage  $D_{MSY}^{CN} = \delta^2 \nu^2 \zeta / (16\beta^2 \gamma^2 \eta^2)$  as well.

The only component of welfare being affected by the tax is the aggregate profit of the industry, because individual profits are  $\pi_{MSY}^{CN} = p(Q_{MSY}^{CN}) \cdot q_{MSY}^{CN} - C(q_{MSY}^{CN}) - \tau \nu q_{MSY}^{CN}/\eta$  and their aggregate value is

$$\Pi_{MSY}^{CN} = n_{MSY}(\tau) \cdot \pi_{MSY}^{CN} = p(Q_{MSY}^{CN}) \cdot Q_{MSY}^{CN} - n_{MSY}(\tau) \cdot C(q_{MSY}^{CN}) - \frac{\tau \nu Q_{MSY}^{CN}}{\eta} \quad (10)$$

Note that aggregate revenues are unaffected by  $\tau$ , which appears only in the total cost function either explicitly (in the tax burden) or implicitly (in  $n_{MSY}(\tau)$  and  $q_{MSY}^{CN}$ , which contains the latter). The partial derivative of (10) is

$$\frac{\partial \Pi_{MSY}^{CN}}{\partial \tau} = - \frac{\eta [C_i(q_{MSY}^{CN}) + n_{MSY}(\tau) \cdot C'(q_{MSY}^{CN})] n'_{MSY}(\tau) + \nu Q_{MSY}^{CN}}{\eta} \quad (11)$$

where

$$C'(q_{MSY}^{CN}) \equiv \frac{\partial C(q_{MSY}^{CN})}{\partial \tau} = \frac{\partial C(q^{CN})}{\partial q} \cdot \frac{\partial q^{CN}}{\partial \tau} \Big|_{n=n_{MSY}(\tau)} < 0$$

$$n'_{MSY}(\tau) \equiv \frac{\partial n_{MSY}(\tau)}{\partial \tau} > 0$$
(12)

Now, if production takes place at constant marginal cost, then  $n_{MSY}(\tau) \cdot C(q_{MSY}^{CN}) = C(Q_{MSY}^{CN})$ , whereby  $C'(Q_{MSY}^{CN}) = 0$  because  $Q_{MSY}^{CN}$  is independent of  $\tau$ . On the other hand, social welfare will be independent of  $\tau$  because of the redistribution of the tax income to consumers. Hence, we may claim

**Proposition 1** *If firms sell a homogeneous good and productive technology is characterised by constant returns to scale, provided access to the commons is regulated to ensure industry harvesting at the MSY, equilibrium welfare will be independent of the emission tax.*

This also implies the following ancillary result:

**Corollary 2** *Under product homogeneity and regulated access to the commons at  $n_{MSY}(\tau)$ , irrespective of the nature of returns to scale in production, the emission tax will have no impact on the size of the environmental damage. Consequently, the public authority may modify tax pressure for purely redistributive purposes.*

This amounts to saying that once industry structure has been "frozen" to guarantee the survival of the biological resource in the long run, the primary effect of the emission tax, originally envisaged to be an instrument to reduce the environmental impact of production and/or consumption, has been entirely sterilised.

This remains largely true (although not 100% so) if we relax the admittedly restrictive assumption concerning product homogeneity to adopt the more realistic view that each firm sells a differentiated variety, in such a way that firm  $i$  faces a product-specific inverse demand function  $p_i(q_i, Q_j)$ , in which  $Q_j = \sum_{j \neq i} q_j$ . This assumption, in particular, implies that individual and industry equilibrium profits will indeed depend on  $\tau$  even under constant returns to scale, as can be ascertained using the well known model in Ottaviano *et al.* (2002), which encompasses the earlier approach due to Singh and Vives (1984).

The specific reason is that equilibrium prices will incorporate the  $n$  firms' outputs in an asymmetric way, due to the presence of even the smallest degree of product differentiation. However, it remains true that fixing  $n$  and consequently  $Q$  to induce the industry to extract the resource from its natural habitat in correspondence of the MSY opens up a novel and interesting perspective on the role of emission taxation, showing that (i) it can be finely tuned to drive emissions and the related environmental damage to zero, although (ii) the tax level achieving this result is systematically higher than that maximising total welfare, precisely because under product differentiation - and irrespective of the

nature of the market regime - the environmental damage is affected by the tax, which partially restores the traditional tradeoff between profits and consumer surplus on one side and the environmental balance on the other (still, were product differentiation *sufficiently small*, this consequence would be *almost negligible*).

A somewhat different story can be told if one admits the possibility for firms to react to emission taxation by investing in abatement technologies, with the twofold objective of cleaning their technology and softening the impact of the emission tax on their profits.

To investigate this scenario, it suffices to modify the above model to include investments in abatement technologies. The simplest way to do so is to assume perfect patent protection, i.e., no spillovers or information leakages across firms. Firm  $i$ 's profit function becomes  $\pi_i(t) = p(Q(t))q_i(t) - C_i(q_i(t)) - \tau s_i(t) - bk_i^2(t)$ , in which  $bk_i^2(t)$  is the instantaneous cost associated with an abatement effort  $k_i(t) > 0$ , this becoming the second control in the hands of each firm. The assumption of convex R&D costs accounts for the presence of decreasing returns in R&D activity. More specifically, the quadratic form of the cost function is explicitly meant to keep the dynamic game analytically solvable. The R&D effort enters the state equation of individual emissions in the following way:

$$\dot{s}_i(t) = \nu q_i(t) - \eta s_i(t) - \phi k_i(t) \quad (13)$$

where  $\phi$  is a positive constant. In this respect, it is worth noting that we identify the present layout of R&D as being for abatement technologies in the sense that it leaves unaltered parameter  $\nu$ , which measures the number of  $CO_2$ -equivalent molecules emitted by production/consumption. We may label this technology as an end-of-pipe device designed to capture carbon before its release in the atmosphere. Conversely, if  $k_i(t)$  were to modify  $\nu$ , the above state equation would write as  $\dot{s}_i(t) = \nu_i(t)q_i(t) - \eta s_i(t) - \phi k_i(t)$  and it would be necessarily accompanied by an additional state equation like  $\dot{\nu}_i(t) = \nu_i(t)[1 - \phi k_i(t)]$ , so that as long as  $k_i(t) < 1/\phi$ ,  $\nu_i(t)$  increases, and conversely. However, the multiplicative effect appearing in the latter equation would prevent the attainment of a degenerate feedback equilibrium under open-loop information (for more on this modelling strategy and its implications, see Dragone *et al.*, 2013).

The remaining building blocks of the model are unmodified, so that the Hamiltonian of firm  $i$  is

$$\begin{aligned} \mathcal{H}_i(t) = & p(Q(t))q_i(t) - C_i(q_i(t)) - \tau s_i(t) - bk_i^2(t) + \\ & \lambda_{ii}(t)[\nu q_i(t) - \eta s_i(t) - \phi k_i(t)] + \sum_{j \neq i} \lambda_{ij}(t)[\nu q_j(t) - \eta s_j(t) - \phi k_j(t)] \\ & + \mu_i(t)[\delta X(t)(1 - \beta X(t)) - \gamma Q(t)] \end{aligned} \quad (14)$$

Given the additive separability of the model w.r.t. controls, the FOC on  $q_i(t)$  and the dynamics of  $\lambda_{ii}(t)$  are the same as above, while we have an additional FOC taken on  $k_i(t)$  (once again, we omit

the time argument):

$$\frac{\partial \mathcal{H}_i}{\partial k_i} = -2bk_i(t) - \lambda_{ii}\phi = 0 \quad (15)$$

Additionally, it remains true that the game is state-redundant and therefore  $\lambda_{ij} = 0$  and  $\mu_i = 0$  at all times.

Since  $\lambda_{ii}$  appears in both FOCs, we have  $\lambda_{ii} = (d\bar{\pi}'/dt + \nu\tau) / [\nu(\eta + \rho)] = -2bk_i/\phi$ . The first option can be used to treat the dynamics of  $q_i$ , while the second is useful to characterise the dynamics of emission abatement:<sup>9</sup>

$$\dot{k}_i = -\frac{\lambda_{ii}\phi}{2b} = \frac{2b(\eta + \rho)k_i - \phi\tau}{2b} \quad (16)$$

solving which at any time  $t$  we obtain the optimal symmetric abatement effort of the generic firm,  $k^*(\tau) = \phi\tau / [2b(\eta + \rho)] + e^{t(\eta + \rho)}\mathbb{C}$ , where the integration constraint  $\mathbb{C}$  can be set equal to zero. Since the above expression is independent of  $n$ , which - as we know from the above discussion - has been in the meantime set equal to  $n_{MSY}(\tau)$  by the regulator, the industry-wide investment in abatement technologies is  $K^*(\tau) = n_{MSY}(\tau) \cdot k^*(\tau)$ , and

$$\frac{\partial K^*(\tau)}{\partial \tau} = \frac{\partial n_{MSY}(\tau)}{\partial \tau} \cdot k^*(\tau) + n_{MSY}(\tau) \cdot \frac{\partial k^*(\tau)}{\partial \tau} > 0 \quad (17)$$

since  $\partial n_{MSY}(\tau) / \partial \tau > 0$  and  $\partial k^*(\tau) / \partial \tau > 0$ .

All else equal, this very fact modifies the picture in one very relevant respect, namely, the regulator's attitude about the proper use of the tax. While in absence of R&D activities on the part of firms the public authority could only think of the emission tax as a redistributive tool, now it sees this environmental policy for what it should indeed be, namely, a tool for triggering and boosting green R&D.

In particular, this exercise has shown the arising of an Arrowian result (Arrow, 1962),<sup>10</sup> according to which increasing the tax drives a monotone increase in the aggregate abatement effort carried out by the entire industry:

**Proposition 3** *If firms react to emission taxation by implementing R&D projects for abatement technology under full patent protection, any tax increase causes individual and aggregate R&D to increase*

<sup>9</sup>As will become evident in the ensuing examples, the two control equations will not, in general, be linearly independent, because of the presence of the adjoint variable in both FOCs. This is surely the case with a linear market demand for a homogeneous good: in this case, the FOC w.r.t.  $q_i(t)$  can be solved to find the optimal individual output.

<sup>10</sup>Arrow (1962) proposed the view, holding that increasing the intensity of competition (or industry fragmentation) would bring to bear higher innovation incentives, in contrast with Schumpeter's (1942) position according to which innovation incentives would be monotonically increasing in market power and concentration. The lively debate discussing these opposite views in the theory of industrial organization can be appreciated by reading Tirole (1988) and Reinganum (1989), *inter alia*. An analogous discussion about green R&D exists in environmental economics as well (see, for example, Feichtinger *et al.*, 2016, and Lambertini *et al.*, 2017).

monotonically since  $n_{MSY}(\tau)$  is itself increasing in the tax rate to guarantee the attainment of the MSY.

Of course, the non-negativity of profits poses an upper bound to the tax increase and therefore also to the expansion of R&D investments, but in line of principle the policy maker can push the tax up to a level at which equilibrium individual profits are positive although arbitrarily small. Indeed, the following example, based upon a linear market demand, will show that the public authority may actually drive the whole industry to a green production pattern. In doing so, we will also assess the relative size of such tax and that associated with welfare maximisation, to illustrate that a government may systematically face a tradeoff between achieving the highest possible degree of greenness and welfare maximisation, and nonetheless this conundrum can be solved through the arising of a win-win solution vindicating the Porter hypothesis. This happens because once technology is green, taxation becomes ineffective and therefore the aforementioned tradeoff vanishes.

Moreover, given the additively separable structure of the model, the presence of product differentiation and/or decreasing returns to scale in production do not affect the above claims. Hence, we have found a perspective that allows a regulator to get two eggs in one basket: first appropriately define  $n$  as a function of  $\tau$  in such a way to preserve the renewable resource forever, and then exploit the monotonicity of  $n_{MSY}(\tau)$  in  $\tau$  to spur firms to clean up their technology.

To illustrate the above results, we may resort to different specialised models based on plausible sets of specific functional forms of demand and cost functions, with and without R&D investments in abatement technologies.

### 3 Linear demand and constant returns to scale

Let the  $n$  Cournot firms supply a homogeneous good whose market demand function is linear,  $p(t) = a - Q(t)$ , where  $a$  is a positive constant. All firms use the same technology at constant returns to scale, whereby the individual instantaneous cost function is  $C_i(q_i(t)) = cq_i(t)$ , where the time-invariant marginal cost  $c \in (0, a)$ . To ease the ensuing exposition, we may define  $A \equiv a - c$ . Each individual firm's emissions  $s_i(t)$  are being taxed at all times at the rate  $\tau > 0$ . Consequently, firm  $i$ 's instantaneous profit function can be written as  $\pi_i(t) = [A - q_i(t) - Q_{-i}(t)]q_i(t) - \tau s_i(t)$ , in which  $Q_{-i}(t) \equiv \sum_{j \neq i} q_j(t)$ . We shall start by illustrating the game in which firms do not invest in abatement technologies.

In absence of green R&D, the problem of firm  $i$  is

$$\begin{aligned} \max_{q_i(t)} \int_0^{\infty} e^{-\rho t} \pi_i(t) dt, \\ \dot{s}_i(t) &= \nu q_i(t) - \eta s_i(t), \quad s_i(0) = s_{i0}, \quad i = 1, 2, \dots, n \\ \dot{X}(t) &= \delta X(t) [1 - \beta X(t)] - \gamma Q(t), \quad X(0) = X_0. \end{aligned} \quad (18)$$

which implies that firm  $i$  must choose its output level to maximise the following Hamiltonian:<sup>11</sup>

$$\mathcal{H}_i = \pi_i + \lambda_{ii} (\nu q_i - \eta s_i) + \sum_{j \neq i} \lambda_{ij} (\nu q_j - \eta s_j) + \mu_i [\delta X (1 - \beta X)] \quad (19)$$

in which  $\{\lambda_{ii}, \lambda_{ij}, \mu_i\}$  is the vector of the  $n+1$  costate variables. The differential game is solved under open-loop information, with firms playing simultaneously and non-cooperatively at all times, which amounts to saying that we are about to characterise the Cournot-Nash open-loop equilibrium and its implications, summarised in the following:

**Proposition 4** *Harvesting at the MSY requires*

$$n = n_{MSY} \equiv \frac{\delta(\eta + \rho)}{4\beta\gamma [A(\eta + \rho) - \nu\tau] - \delta(\eta + \rho)}$$

with  $n_{MSY}$  being positive and at least equal to one for all  $A \in (A_{min}, A_{max})$ , where

$$\begin{aligned} A_{min} &\equiv \frac{4\beta\gamma\nu\tau + \delta(\eta + \rho)}{4\beta\gamma(\eta + \rho)} \\ A_{max} &\equiv \frac{2\beta\gamma\nu\tau + \delta(\eta + \rho)}{2\beta\gamma(\eta + \rho)} \end{aligned}$$

The proof can be found in appendix A.2 and is based on the derivation of the stable steady state of the renewable resource. Imposing  $X = 1/(2\beta)$  and solving for the number of firms indeed gives the above assertion.

Using this result we see from

$$\frac{\partial n_{MSY}}{\partial \tau} = \frac{4\beta\delta\gamma\nu(\eta + \rho)}{[4\beta\gamma(A(\eta + \rho) - \nu\tau) - \delta(\eta + \rho)]^2} > 0 \quad (20)$$

that increasing taxation must go along with expanding access to the commons in order for the industry to keep harvesting the resource at the MSY, to compensate the negative effect of emission taxation on the steady state value of production  $\hat{q}$ :

$$\frac{\partial \hat{q}}{\partial \tau} = -\frac{\nu}{(n+1)(\eta + \rho)} \quad (21)$$

Now we may look at the equilibrium level of the environmental damage, which, for a generic industry structure, amounts to

$$\hat{D}(n) = \frac{n^2\nu^2\zeta [A(\eta + \rho) - \nu\tau]^2}{(n+1)^2\eta^2(\eta + \rho)^2} \quad (22)$$

<sup>11</sup>Henceforth we shall omit the explicit indication of the time argument for the sake of brevity.

However, once  $n = n_{MSY}$ , this simplifies as  $\widehat{D}(n_{MSY}) = \delta^2 \nu^2 \zeta / (16\beta^2 \gamma^2 \eta^2)$ , i.e., it becomes independent of the emission tax, and the same of course applies to the equilibrium level of aggregate emissions. Moreover, the same holds for aggregate output, which corresponds to  $\widehat{Q}(n_{MSY}) = \delta / (4\beta\gamma)$ , and consequently also for consumer surplus,  $\widehat{CS}(n_{MSY}) = \delta^2 / (32\beta^2 \gamma^2)$ .

Therefore, we may claim:

**Proposition 5** *Once the policy maker pursues the attainment of harvesting at the MSY, the environmental balance  $X_{MSY} - \widehat{D}(n_{MSY})$  is independent of industry structure.*

This of course is not true for profits,  $n_{MSY} \cdot \widehat{\pi}(n_{MSY}) = \delta [4\beta\gamma\eta(A - \tau) - \delta\eta] / (16\beta^2 \gamma^2 \eta)$ , due to the presence of the emission tax. However, since the income generated by emission taxation is being redistributed, the equilibrium level of social welfare is indeed independent of the tax:

$$\widehat{SW}(n_{MSY}) = \frac{16\beta\gamma^2 \eta^2 + \delta [(8A\beta\gamma - \delta) \eta^2 - 2\delta\nu^2 \zeta]}{32\beta^2 \gamma^2 \eta^2} \quad (23)$$

Note that  $\widehat{SW}(n_{MSY})$  may take a negative value. A sufficient condition for this not to happen is  $A \geq \widehat{A}(n_{MSY}) \equiv \delta (\eta^2 + 2\nu^2 \zeta) / (8\beta\gamma\eta^2)$ . Hence, the detailed exposition of the model with linear demand, product homogeneity and constant returns to scale confirms the contents of Proposition 1 and Corollary 2, whereby we may reformulate those conclusions as follows:

**Proposition 6** *If firms sell a homogeneous good with a common technology characterised by a constant marginal cost, limiting access at  $n_{MSY}$  sterilises the emission tax, which has no impact on the environmental damage and can be exclusively used to redistribute surplus between firms and consumers.*

### 3.1 Abatement technology

We are now in a position to expand the above model in order for it to accommodate firms' R&D efforts in abatement technologies, spurred by emission taxation. In this setting, each firm controls two variables, output and the R&D effort, the latter involving a convex instantaneous cost and entering the kinematics of  $s_i$ , in such a way that the key elements of the model can be described as follows. Instantaneous individual profits are  $\pi_i(t) = [A - Q(t)] q_i(t) - \tau s_i(t) - bk_i^2(t)$ , and the relevant state equation of individual emissions becomes (13), which is based on the assumption that the individual firm receives no spillover from any of the rivals.

Hence, firm  $i$ 's Hamiltonian is

$$\begin{aligned} \mathcal{H}_i(t) = & [A - Q(t)] q_i(t) - \tau s_i(t) - bk_i^2(t) + \lambda_{ii}(t) [\nu q_i(t) - \eta s_i(t) - \phi k_i(t)] + \\ & \sum_{j \neq i} \lambda_{ij}(t) [\nu q_j(t) - \eta s_j(t) - \phi k_j(t)] + \mu_i(t) [\delta X(t) (1 - \beta X(t)) - \gamma Q(t)] \end{aligned} \quad (24)$$

and therefore the FOC taken w.r.t. the abatement effort is (15). Our purpose here is to illustrate explicitly the arising of the result appearing in Proposition 3, by proving

**Proposition 7** *If firms undertake R&D projects for abatement technologies under full patent protection, and the regulator imposes  $n = n_{MSY}(\tau)$ , there exists a unique emission tax rate  $\tau^*$  at which individual and aggregate emissions drop to zero.*

The proof (formulated in appendix A.3) derives the environmental damage in the steady state of the corresponding situation and explores the emission tax rate at which the damage is nil.

As for aggregate R&D,  $\widehat{K}(n_{MSY}(\tau)) = \delta\phi\tau / [2b((4A\beta\gamma - \delta)(\eta + \rho) - 4\beta\gamma\nu\tau)]$ , we have that  $\partial\widehat{K}(n_{MSY}(\tau)) / \partial\tau > 0$  always, which proves the following

**Corollary 8** *If firms undertake R&D projects for abatement technologies under full patent protection, and the regulator imposes  $n = n_{MSY}(\tau)$ , then aggregate R&D investment is monotonically increasing in the emission tax rate.*

Finally, simplifying the expressions of individual output, profits and social welfare, we obtain

$$\begin{aligned} \widehat{q}(n_{MSY}(\tau), \tau^*) &= \frac{(4A\beta\gamma - \delta)\phi^2}{4\beta\gamma(2b\nu^2 + \phi^2)} \\ \widehat{\pi}(n_{MSY}(\tau), \tau^*) &= \frac{(4A\beta\gamma - \delta)^2\phi^2(b\nu^2 + \phi^2)}{16\beta^2\gamma^2(2b\nu^2 + \phi^2)^2} \\ \widehat{SW}(n_{MSY}(\tau), \tau^*) &= \frac{8b\beta\gamma\nu^2[(a-c)\delta + 4\gamma] + [8\beta\gamma(A\delta + 2\gamma) - \delta^2]\phi^2}{32\beta^2\gamma^2(2b\nu^2 + \phi^2)^2} \end{aligned} \quad (25)$$

where  $\widehat{q}(n_{MSY}(\tau), \tau^*)$  and  $\widehat{\pi}(n_{MSY}(\tau), \tau^*)$  are positive in view of the constraint ensuring the positivity of the output level at any instant. Consequently, in this setting the regulator need not take into account the non-negativity of either outputs or profits when looking for the tax rate driving the whole industry along a sustainable path. However, once again the equilibrium welfare level may take a negative value. A sufficient condition for this not to happen is  $A \geq \widehat{A}(n_{MSY}(\tau), \tau^*) \equiv (\delta^2 - 16\beta\gamma^2) / (8\beta\gamma\delta)$ , and it is easily checked that  $\widehat{A}(n_{MSY}(\tau), \tau^*) < \widehat{A}(n_{MSY})$  always.

Additionally, we may briefly dwell upon the possibility for the public authority to implement the welfare-maximising tax rate. In this respect, it is easily checked that, in correspondence of  $\tau = \tau^*$ , the partial derivative of  $\widehat{SW}(n_{MSY}(\tau))$  w.r.t. to  $\tau$  simplifies to

$$\left. \frac{\partial\widehat{SW}(n_{MSY}(\tau))}{\partial\tau} \right|_{\tau=\tau^*} = -\frac{\delta\nu(b\nu^2 + \phi^2)}{4\beta\gamma(\eta + \rho)\phi^2} < 0 \quad (26)$$

which reveals that the welfare-maximising tax falls short of the tax rate ensuring the elimination of polluting emissions. This, intuitively, is imputable to the presence of  $\tau$  in the expression of equilibrium profits, and is a potential source of conflicts inside a government. The same problem reproduces itself in the remainder of the paper, with the equivalent of (26) holding systematically across market regimes.

Needless to say, the result spelled out in Proposition 7 should be considered with some caution, as one cannot expect emissions to literally drop to zero. However, this setup says that there exists a scenario in which regulating access and emissions may create a synergy that has remained overlooked thus far, capable of creating a sustainable path accounting for two key dimensions, i.e., the preservation of natural resources and a significant reduction of polluting emissions. This prompts for a check of the Porter hypothesis in its strong form.

### 3.2 A validation of the Porter hypothesis

Now we are in a position to comparatively assess equilibrium profits and welfare levels engendered by the two scenarios analysed thus far. This exercise is carried out by posing  $\tau = \tau^*$  in  $\hat{\pi}(n_{MSY})$ , so as to verify whether the tax rate driving to zero emissions in the game including investment in abatement technologies is conducive to the win-win solution. As for profits, we have

$$\hat{\pi}(n_{MSY}(\tau), \tau^*) - \hat{\pi}(n_{MSY}) = \frac{b(4A\beta\gamma - \delta^2)(\eta + 2\rho)\phi^2\nu^2}{16\beta^2\gamma^2\eta(2b\nu^2 - \phi^2)} > 0 \quad (27)$$

always, while the comparison of welfare levels yields

$$\widehat{SW}(n_{MSY}(\tau), \tau^*) - \widehat{SW}(n_{MSY}) = \frac{[(b(\eta^2 + 2\nu^2\zeta) + \phi^2\zeta)\delta - 4Ab\beta\gamma\eta^2]\delta\nu^2}{16\beta^2\gamma^2\eta^2(2b\nu^2 - \phi^2)} \quad (28)$$

which is positive for all  $A \in (0, A_{PH})$ ,  $A_{PH} \equiv [b(\eta^2 + 2\nu^2\zeta) + \phi^2\zeta]\delta / (4b\beta\gamma\eta^2)$ . As a last step, it is easily checked that  $A_{PH} > \hat{A}(n_{MSY}) > \hat{A}(n_{MSY}(\tau), \tau^*)$ . Accordingly, we may formulate the following

**Proposition 9** *If  $A \in (\hat{A}(n_{MSY}), A_{PH})$ , the adoption of  $\tau^*$  delivers the win-win solution.*

The driver of this result can be found in the fact that, if  $\tau = \tau^*$ , welfare goes up since emissions and the related environmental damage are nil, but this also implies that in correspondence of  $\tau^*$  the tax burden borne by firms at equilibrium is also nil. It is also worth stressing that the win-win solution is a consequence of the parallel policy regulating access to the common pool, which sterilises the effects of emission taxation, thereby ensuring that consumers are not harmed; indeed, as we know from the proof of Proposition 7, consumer surplus is  $\widehat{CS}(n_{MSY}(\tau)) = \delta^2 / (32\beta^2\gamma^2)$  irrespective of the level of the tax. Hence, the regulator may generate a win-win solution without any tradeoff between consumer and producer surplus, and what at first sight may appear as a simple redistributive mechanism confined to a special case turns out in fact to open the path to the vindication of the Porter hypothesis in its strong form.

## 4 Extensions: decreasing returns, product differentiation and monopolistic competition

Here we extend the model to encompass convex production costs, the representative consumer's preference for variety and monopolistically competitive behaviour on the part of firms, each of which is supplying a single variety. The first variation entails that firm  $i$ 's instantaneous cost function becomes  $C_i(q_i(t)) = cq_i(t) + dq_i^2(t)$ , with  $d$  being a positive constant. The second and third extensions require a new definition of the demand structure engendered by consumers' taste for variety, which makes it possible to characterise both oligopolistic and monopolistically competitive equilibria. To this aim, we adopt the same utility function as in Ottaviano *et al.* (2002) and the subsequent literature.<sup>12</sup> The preferences of the representative consumer at any instant  $t$  are described by the following utility function:

$$U = a \sum_{i=1}^n q_i(t) - \frac{\xi - \sigma}{2} \sum_{i=1}^n q_i^2(t) - \frac{\sigma}{2} \left( \sum_{i=1}^n q_i(t) \right)^2 + q_0(t) \quad (29)$$

where  $q_0(t)$  is the numeraire good, while  $\xi$  and  $\sigma$  are constants, with  $\xi > 0$  and  $\sigma \in [-\xi, \xi]$ , in such a way that if  $\sigma < 0$ , consumers want to buy complements, if  $\sigma > 0$ , consumers want to buy substitutes, and  $\sigma = 0$  each good is sold on a different market (and each firm is a pure monopolist). Hence, any  $\sigma \in (0, \xi)$  provides an inverse measure of substitutability between any two imperfectly substitutable varieties. The homogeneous good case arises if  $\sigma = \xi$ .

The individual inverse demand function resulting from the constrained maximization of (29) is

$$p_i(t) = a - (\xi - \sigma) q_i(t) - \sigma \sum_{i=1}^n q_i(t) \quad (30)$$

if firms are Cournot oligopolists, and

$$p_i(t) = a - (\xi - \sigma) q_i(t) - \sigma Q(t) \quad (31)$$

if they are monopolistically competitive. In the above demand functions, the appearance of aggregate output  $Q(t)$  indicates that under monopolistic competition each individual firm is unaware of its role in the aggregate behaviour of the industry. Note that if  $\sigma = \xi = 1$ , we are back to the homogeneous good case investigated initially.

In both scenarios, the instantaneous profit function of firm  $i$  is

$$\pi_i(t) = [p_i(t) - c - dq_i(t)] q_i(t) - \tau s_i(t) \quad (32)$$

if firms do not invest in emission abatement, and

$$\pi_i(t) = [p_i(t) - c - dq_i(t)] q_i(t) - \tau s_i(t) - bk_i^2(t) \quad (33)$$

<sup>12</sup>In particular, the detailed illustration of the monopolistically competitive equilibrium emerging from (29) can be found in Cellini *et al.* (2004, 2020).

if they do, and  $p_i(t)$  must be replaced with the appropriate version of the inverse demand function depending on the nature of market competition. As in section 3, to save upon notation we shall define  $A \equiv a - c$ . We set out to illustrate the first case, under the assumption that firms are Cournot oligopolists.

#### 4.1 The oligopoly game

If Cournot firms only choose output levels, the relevant Hamiltonian of the generic firm is

$$\begin{aligned} \mathcal{H}_i(t) = & \left[ a - (\xi - \sigma) q_i(t) - \sigma \sum_{i=1}^n q_i(t) - c - dq_i(t) \right] q_i(t) - \tau s_i(t) + \\ & \lambda_{ii}(t) [\nu q_i(t) - \eta s_i(t) - \phi k_i(t)] + \sum_{j \neq i} \lambda_{ij}(t) [\nu q_j(t) - \eta s_j(t) - \phi k_j(t)] + \\ & \mu_i(t) [\delta X(t) (1 - \beta X(t)) - \gamma Q(t)] \end{aligned} \quad (34)$$

The solution of this game leads to the following

**Proposition 10** *If the differential game takes place under product differentiation and decreasing returns to scale in production, regulating access to the commons at  $n_{MSY}^{CN}$  makes environmental damage independent of the emission tax. Hence, the latter has at most a purely redistributive effect on profits and consumer surplus.*

The complete proof is formulated in appendix A.4 explores the role of emission tax in the corresponding steady state.

#### 4.2 Abatement technology with product differentiation

As in section 3.1, the presence of investments in emission abatement implies that each firm has two controls. The Hamiltonian function becomes

$$\begin{aligned} \mathcal{H}_i(t) = & \left[ a - (\xi - \sigma) q_i(t) - \sigma \sum_{i=1}^n q_i(t) - c - dq_i(t) \right] q_i(t) - \tau s_i(t) - bk_i^2(t) + \\ & \lambda_{ii}(t) [\nu q_i(t) - \eta s_i(t) - \phi k_i(t)] + \sum_{j \neq i} \lambda_{ij}(t) [\nu q_j(t) - \eta s_j(t) - \phi k_j(t)] \\ & + \mu_i(t) [\delta X(t) (1 - \beta X(t)) - \gamma Q(t)] \end{aligned} \quad (35)$$

The outcome of this game is summarised in

**Proposition 11** *If the differential game takes place under product differentiation and decreasing returns to scale in production, regulating access to the commons at  $n_{MSY}$  allows the regulator to use the tax to boost firms' abatement effort in order to minimise individual and aggregate emissions as well as the resulting environmental damage.*

Building upon the proof of the previous Proposition, the proof (see appendix A.5) explores the additive separability. It can be shown that the emission tax rate can be used to minimize the emissions and environmental damage (by choosing the tax rate such that the corresponding derivative is nil).

### 4.3 Monopolistic competition

The last scenario we want to illustrate is that in which firms behave as monopolistically competitive agents, and the relevant specification of the individual demand function is (31). To begin with, we look at the case in which firms control output levels only. Each firm  $i$  maximises its discounted flow of profits, whose instantaneous expression is (32), under the set of constraints

$$\begin{aligned} \dot{s}_i(t) &= \nu q_i(t) - \eta s_i(t), \quad s_i(0) = s_{i0}, \quad i = 1, 2, \dots, n \\ \dot{X}(t) &= \delta X(t) [1 - \beta X(t)] - \gamma Q(t), \quad X(0) = X_0 \end{aligned} \quad (36)$$

and becomes aware of the fact that  $Q(t) = q_i(t) + \sum_{j \neq i} q_j(t)$  only after taking FOCs.

The relevant Hamiltonian is

$$\begin{aligned} \mathcal{H}_i(t) &= [A - (\xi - \sigma) q_i(t) - \sigma Q(t) - d q_i(t)] q_i(t) - \tau s_i(t) + \\ &\lambda_{ii}(t) [\nu q_i(t) - \eta s_i(t) - \phi k_i(t)] + \sum_{j \neq i} \lambda_{ij}(t) [\nu q_j(t) - \eta s_j(t) - \phi k_j(t)] \\ &+ \mu_i(t) [\delta X(t) (1 - \beta X(t)) - \gamma Q(t)] \end{aligned} \quad (37)$$

and therefore the FOC is

$$A - 2(d + \xi - \sigma) q_i - \sigma Q + \lambda_{ii} \nu = 0 \quad (38)$$

while costate equations are the same as above, and we may set  $\lambda_{ij} = \mu_i = 0$  at all times, for all  $j \neq i$ . Now, posing  $\lambda_{ii} = \lambda$ ,  $q_i = q$  and  $Q = nq$ , from (38) we obtain  $q^{mc} = (A + \lambda \nu) / [2(d + \xi) + \sigma(n - 2)]$ , where superscript *mc* mnemonics for monopolistic competition. Therefore, the control equation is

$$\dot{q}^{mc} = \frac{\lambda \nu}{2(d + \xi) + \sigma(n - 2)} = \frac{[\lambda(\eta + \rho) + \tau] \nu}{2(d + \xi) + \sigma(n - 2)} \quad (39)$$

which, given that  $\lambda = [(2(d + \xi) + \sigma(n - 2))q - A] / \nu$ , can be rewritten in its final form as

$$\dot{q}^{mc} = \frac{(\eta + \rho) [(2(d + \xi) + \sigma(n - 2))q - A] + \nu \tau}{2(d + \xi) + \sigma(n - 2)} \quad (40)$$

The stable steady state has the following coordinates:

$$\begin{aligned} \hat{s}^{mc} &= \frac{\nu [A(\eta + \rho) - \nu \tau]}{\eta(\eta + \rho) [2(d + \xi) + \sigma(n - 2)]} = \frac{\nu}{\eta} \hat{q}^{mc} \\ \hat{X}_+^{mc} &= \frac{\delta(\eta + \rho) (2(d + \xi) + \sigma(n - 2)) + \sqrt{\Xi}}{2\beta\delta(\eta + \rho) [2(d + \xi) + \sigma(n - 2)]} \\ \hat{q}^{mc} &= \frac{A(\eta + \rho) - \nu \tau}{(\eta + \rho) [2(d + \xi) + \sigma(n - 2)]} \end{aligned} \quad (41)$$

where

$$\begin{aligned} \Xi &\equiv \delta(\eta + \rho) [2(d + \xi) + \sigma(n - 2)] \times \\ &[\delta(\eta + \rho) (2(d + \xi) + \sigma(n - 2)) - 4n\beta\gamma(A(\eta + \rho) - \nu\tau)] \end{aligned} \quad (42)$$

and the number of firms ensuring that the harvest is carried out at the  $MSY$  is

$$n_{MSY}^{mc}(\tau) = \frac{2\delta(\eta + \rho)(d + \xi - \sigma)}{(\eta + \rho)(4A\beta\gamma - \delta\sigma) - 4\beta\gamma\nu\tau} \quad (43)$$

which, unsurprisingly, entails that the resulting environmental industry output and environmental damage coincide with (76). This, together with the parallel result that  $\widehat{X} = 1/(2\beta)$ , immediately implies the following

**Proposition 12** *As far as the environmental balance is concerned, once access to the commons is regulated to ensure harvesting at the  $MSY$ , monopolistic competition is observationally equivalent to the differentiated oligopoly, all else equal.*

Of course the same does not hold when it comes to the output and price levels of each single product variety. To see this, it is sufficient to compare the expression of the equilibrium individual output under monopolistic competition,

$$\widehat{q}^{mc}(n_{MSY}^{mc}(\tau)) = \frac{(4A\beta\gamma - \delta\sigma)(\eta + \rho) - 4\beta\gamma\nu\tau}{8\beta\gamma(\eta + \rho)(d + \xi - \sigma)} \quad (44)$$

with the corresponding level in oligopoly, to see that

$$\widehat{q}^{mc}(n_{MSY}^{mc}(\tau)) - \widehat{q}^{CN}(n_{MSY}^{CN}(\tau)) = \frac{\sigma[(4A\beta\gamma - \delta\sigma)(\eta + \rho) - 4\beta\gamma\nu\tau]}{8\beta\gamma(\eta + \rho)(d + \xi - \sigma)[2(d + \xi) - \sigma]} > 0 \quad (45)$$

in the parameter range wherein both  $\widehat{q}^{mc}(n_{MSY}^{mc}(\tau))$  and  $\widehat{q}^{CN}(n_{MSY}^{CN}(\tau))$  are positive. Then, necessarily,  $n_{MSY}^{mc}(\tau) < n_{MSY}^{CN}(\tau)$ , simply because, given  $\widehat{Q}^{cm}(n_{MSY}^{cm}(\tau)) = \widehat{Q}^{CN}(n_{MSY}^{CN}(\tau))$ , each monopolistically competitive firm produces more than its oligopolistic counterpart. The last related remark concerns the associated equilibrium prices, whose expressions can be calculated on the basis of

$$\widehat{p}^J(n_{MSY}^J(\tau)) = a - [\xi + \sigma(n_{MSY}^J(\tau) - 1)]\widehat{q}^J(n_{MSY}^J(\tau)), \quad J = CN, mc \quad (46)$$

Their difference is

$$\begin{aligned} \widehat{p}^{CN}(n_{MSY}^{CN}(\tau)) - \widehat{p}^{mc}(n_{MSY}^{mc}(\tau)) &= \frac{(\xi - \sigma)\sigma[(4A\beta\gamma - \delta\sigma)(\eta + \rho) - 4\beta\gamma\nu\tau]}{8\beta\gamma(\eta + \rho)(d + \xi - \sigma)[2(d + \xi) - \sigma]} \\ &= (\xi - \sigma)[\widehat{q}^{mc}(n_{MSY}^{mc}(\tau)) - \widehat{q}^{CN}(n_{MSY}^{CN}(\tau))] > 0, \end{aligned} \quad (47)$$

and the reason can be found in the different interplay between individual output and the number of firms being granted access to the commons in the two regimes, as it appears from (46): the ranking of

prices across regimes tells that the individual output restriction due to oligopolistic behaviour matters more than the increase in the number of firms as compared to monopolistic competition.

It is also worth adding that, almost paradoxically, the fact that  $n_{MSY}^{mc}(\tau) < n_{MSY}^{CN}(\tau)$  implies that consumers are offered a wider range of varieties in oligopoly than in monopolistic competition, and at higher market prices - as opposed to the traditional wisdom we have inherited from Helpman and Krugman (1985, 1989) and the subsequent literature - precisely because access to the commons is regulated so as to spur the industry to harvest at the *MSY*.

#### 4.4 Abatement technology under monopolistic competition

Here the monopolistic competition model is modified to include R&D for emission abatement, in the same form as in section 3.1. The Hamiltonian of firm  $i$  becomes

$$\begin{aligned} \mathcal{H}_i(t) = & [A - (\xi - \sigma)q_i(t) - \sigma Q(t) - dq_i(t)]q_i(t) - \tau s_i(t) - bk_i^2(t) + \\ & \lambda_{ii}(t)[\nu q_i(t) - \eta s_i(t) - \phi k_i(t)] + \sum_{j \neq i} \lambda_{ij}(t)[\nu q_j(t) - \eta s_j(t) - \phi k_j(t)] \\ & + \mu_i(t)[\delta X(t)(1 - \beta X(t)) - \gamma Q(t)] \end{aligned} \quad (48)$$

accompanied by the usual set of initial and transversality conditions. We may skip the detailed exposition of FOCs and costate equations, to focus on the essential elements. Again, control equations are not linearly independent; hence, we must solve a system made up by three differential equations and the FOC on output,

$$\begin{aligned} \dot{k} &= k(\eta + \rho) - \frac{\phi\tau}{2b} \\ A - [2(d + \xi) + \sigma(n - 2)]q - \frac{2b\nu k}{\phi} &= 0 \\ \dot{s} &= \nu q - \eta s - \phi k \\ \dot{X} &= \delta X(1 - \beta X) - \gamma(n - 1)q \end{aligned} \quad (49)$$

which delivers the following stable steady state equilibrium:

$$\begin{aligned} \hat{s}^{mc} = \frac{\nu \hat{q}^{mc} - \phi \hat{k}^{mc}}{\eta}; \hat{X}_+^{mc} &= \frac{\delta + \sqrt{\delta \left( \delta - \frac{4n\beta\gamma[A(\eta + \rho) - \nu\tau]}{(\eta + \rho)[2(d + \xi) + \sigma(n - 2)]} \right)}}{2\beta\delta} \\ \hat{q}^{mc} = \frac{A\phi - 2b\nu \hat{k}^{mc}}{\phi[2(d + \xi) + \sigma(n - 2)]}; \hat{k}^{mc} &= \frac{\phi\tau}{2b(\eta + \rho)} \end{aligned} \quad (50)$$

Now note that

**Remark 13**  $\hat{k}^{mc} = \hat{k}^{CN}$  if  $\tau$  is given.

This of course is due to the additive separability of the model, which imply that, all else equal, the individual firm exerts exactly the same effort irrespective of the nature of market competition; but, as

we are about to see, the equilibrium emission tax, as well as the optimal industry structure, cannot be invariant in the market regime.

The number of firms needed for the industry harvest to take place at the  $MSY$  is  $n_{MSY}^{mc}(\tau)$ , the same as in (43), for any generic tax rate. Moreover, we also now that  $n_{MSY}^{CN}(\tau) > n_{MSY}^{mc}(\tau)$ , which has a straightforward implication, namely, that Cournot firms, outnumbering they monopolistically competitive counterparts, will outperform them as far as the aggregate R&D effort for abatement technologies is concerned. This claim can be formulated as follows:

**Proposition 14** *For any given tax rate  $\tau$ , since  $n_{MSY}^{CN}(\tau) > n_{MSY}^{mc}(\tau)$ , then  $\widehat{K}^{CN}(n_{MSY}^{CN}(\tau)) > \widehat{K}^{mc}(n_{MSY}^{mc}(\tau))$ .*

To complete the picture, we may note that the claims contained in Propositions 10-11 can be replicated for monopolistic competition as well. Moreover,  $Q = \widehat{Q}^{cm}(n_{MSY}^{cm}(\tau))$  and the steady state equilibrium level of the environmental damage

$$\widehat{D}^{cm}(n_{MSY}^{cm}(\tau)) = \frac{\zeta [b\delta\nu((\eta + \rho)(4A\beta\gamma - \delta\rho) - 4\beta\gamma\nu\tau) + 4\beta\gamma\delta(d + \xi - \sigma)\phi^2\tau]^2}{16b^2\beta^2\gamma^2\eta^2[(\eta + \rho)(4A\beta\gamma - \delta\rho) - 4\beta\gamma\nu\tau]^2} \quad (51)$$

takes its minimum (equal to zero) at

$$\tau^{mc} = \frac{b\nu(\eta + \rho)(4A\beta\gamma - \delta\rho)}{4\beta\gamma[b\nu^2 + (d + \xi - \sigma)\phi^2]} > 0 \quad (52)$$

and comparing (52) with (82) we obtain

$$\tau^{mc} - \tau^{CN} = \frac{b\nu(\eta + \rho)\sigma(4A\beta\gamma - \delta\rho)\phi^2}{4\beta\gamma[b\nu^2 + (d + \xi - \sigma)\phi^2][2b\nu^2 + (2(d + \xi) - \sigma)\phi^2]} > 0 \quad (53)$$

which proves

**Corollary 15** *If  $n = n_{MSY}^J(\tau)$ ,  $J \in \{CN, cm\}$ , then  $\tau^{mc} > \tau^{CN}$  in the whole parameter range in which equilibrium magnitudes are positive in both market regimes.*

Intuitively, this is due to the different number of firms supplying the market in the two cases. Once  $\widehat{K}^J(n_{MSY}^J(\tau))$  has been simplified by using the appropriate expression for  $\tau^J$ , we may draw the obvious conclusion that aggregate (but not individual) abatement efforts coincide across regimes at  $\widehat{K}^{CN}(n_{MSY}^{CN}(\tau^{CN})) = \widehat{K}^{mc}(n_{MSY}^{mc}(\tau)) = \delta\nu/4\beta\gamma\phi$ , which allows us to formulate our last claim:

**Corollary 16** *If  $n = n_{MSY}^J(\tau)$  and  $\tau = \tau^J$ ,  $J \in \{CN, cm\}$ , then Cournot oligopoly and monopolistic competition are observationally equivalent in terms of aggregate R&D investment for emission abatement.*

## 5 Concluding remarks

Very often, and for a long time, resource exploitation and the environmental damage brought about by polluting emissions have been treated separately. This is reasonable in view of the analytical tractability of both issues when taken in isolation. However, it is intuitive that they are intimately connected, as the global economic system extracts natural resources to supply markets around the globe with consumption goods, and this involves a growing volume of  $CO_2$ -equivalent emissions which can be imputed to either production or consumption or, most commonly, both. This very fact prompts for comprehensive models investigating both sides of the coin together, and assessing the role and scope of regulation in a full-fledged setup.

With this in mind, we have proposed a differential game in oligopoly or monopolistic competition which, relying on the arising of a strongly time consistent equilibrium under open-loop rules, reveals that regulating access to the commons so as to ensure the long-run sustainability of renewable resource extraction implies that emission taxation may only determine a welfare-neutral surplus transfer between consumers and producers, or may be redirected to increase investments in green technologies as much as possible. In line of principle, so much so that it might also reduce emissions and the related environmental damage to zero. In this case, we have also found out a confirmation of the arising of a win-win solution confirming the Porter hypothesis, under a plausible conditions on parameters.

Our analysis has left intentionally aside the identification of the welfare-maximising tax (which, however, in the basic setup does not exist) and its relation with the marginal environmental damage, precisely because it can be used to drive emissions very close to zero in terms of the theoretical model and, more realistically, below a given threshold compatible with the objectives of the Paris Agreement and the explicit indications by IPCC from COP24 onwards. Moreover, this first attempt at modelling the dynamics of resource extraction and greenhouse gases together seems promising in terms of the possibility of investigating the analogous problem related to the exploitation of non-renewables - in particular, fossil fuels - and its cumulative impact on climate. In this respect, this contribution shares several features with a parallel discussion taking place in the area of industrial organization, very well accounted for in Asker (2020).

Additionally, the foregoing approach to the design of a bidimensional policy menu to deal with natural resource preservation and the drastic reduction of  $CO_2$ -equivalent emissions offers a few insights about both the attainment of the net zero emission target at 2050 explicitly stated at COP26 and the holistic view contained in the SDGs appearing in the UN Agenda 2030. In particular, several aspects of the model illustrated here are connected with SDGs 9 (Industry, innovation and infrastructure), 13 (Climate action), 14 (Life below water), 15 (Life on land) and of course with 15 (Climate action).

## A Appendix

### A.1 Double commons

The easiest way of approaching the double commons case consists in substituting the set of  $n$  state equations (2) with  $\dot{S}(t) = \nu \sum_{i=1}^n q_i(t) - \eta S(t)$  to reconstruct the analysis appearing in section 3, on the basis of the Hamiltonian function of the single firm now being written as

$$\mathcal{H}_i = \pi_i + \lambda_i \left( \nu \sum_{i=1}^n q_i - \eta S \right) + \mu_i [\delta X (1 - \beta X)] \quad (54)$$

with  $\pi_i = (A - q_i - Q_{-i}) q_i - \tau S$ . From the FOC

$$A - 2q_i - \sum_{j \neq i} q_j + \lambda_i \nu - \mu_i \gamma = 0 \quad (55)$$

and the set of costate equations

$$\begin{aligned} \dot{\lambda}_i &= (\eta + \rho) \lambda_i + \tau \\ \dot{\mu}_i &= [\delta (2X\beta - 1) + \rho] \mu \end{aligned} \quad (56)$$

we obtain  $q^{CN} = (A + \lambda\nu) / (n + 1)$ ,  $\lambda_i = [(n + 1)q^{CN} - A] / \nu$  and  $\mu_i = 0$  for all  $i = 1, 2, \dots, t$  at all times. Then, the control equation  $\dot{q} = \lambda\nu / (n + 1)$  can be written explicitly to verify that it coincides with (61). Hence, the coordinates of the steady state are

$$\begin{aligned} \widehat{S} &= \frac{n\nu [A(\eta + \rho) - \nu\tau]}{(n + 1)\eta(\eta + \rho)} = \frac{n\nu}{\eta} \widehat{q} \\ \widehat{X}_{\pm} &= \frac{(n + 1)\delta(\eta + \rho) \pm \sqrt{\Upsilon}}{2(n + 1)\beta\delta(\eta + \rho)}; \widehat{q} = \frac{A(\eta + \rho) - \nu\tau}{(n + 1)(\eta + \rho)} \end{aligned} \quad (57)$$

where  $\Upsilon \equiv (n + 1)\delta(\eta + \rho) [(n + 1)\delta(\eta + \rho) - 4n\beta\gamma(A(\eta + \rho) - \nu\tau)]$ . Again,  $\widehat{q} > 0$  implies  $\widehat{X}_+ \geq \widehat{X}_- > 0$ . For obvious reasons, the number of firms delivering  $\widehat{X}_+ = X_{MSY} = 1 / (2\beta)$  is  $n_{MSY}$ , whereby we obtain  $\widehat{D}(n_{MSY}) = \delta^2 \nu^2 \zeta / (16\beta^2 \gamma^2 \eta^2)$ ,  $\widehat{Q}(n_{MSY}) = \delta / (4\beta\gamma)$  and  $\widehat{CS}(n_{MSY}) = \delta^2 / (32\beta^2 \gamma^2)$ , while individual profits differ from those appearing at the steady state of the model in section 3 because each firm is taxed on the basis of industry-wide emissions.

Now, should firms activate R&D projects to abate polluting emissions, one ought to rewrite the state equation as  $\dot{S}(t) = \nu \sum_{i=1}^n q_i(t) - \eta S(t) - \phi \sum_{i=1}^n k_i(t)$ , relying on the disputable assumption that all of them do invest, but this would entail describing a situation in which any individual effort would amount to delivering a public good and therefore could easily trigger a free-riding problem as every single firm could internalise the benefits generated by any abatement effort carried out by rivals.

## A.2 Proof of Proposition 4

The FOC on individual output is

$$A - 2q_i - \sum_{j \neq i} q_j + \lambda_{ii}\nu - \mu_i\gamma = 0 \quad (58)$$

which yields

$$\lambda_{ii} = \frac{2q_i + \sum_{j \neq i} q_j + \mu_i\gamma - A}{\nu} \quad (59)$$

and it is accompanied by the following costate equations:

$$\begin{aligned} \dot{\lambda}_{ii} &= (\eta + \rho)\lambda_{ii} + \tau \\ \dot{\lambda}_{ij} &= (\eta + \rho)\lambda_{ij} \\ \dot{\mu}_i &= [\delta(2X\beta - 1) + \rho]\mu \end{aligned} \quad (60)$$

and the transversality conditions  $\lim_{t \rightarrow \infty} \lambda_{ii}s_i = 0$ ,  $\lim_{t \rightarrow \infty} \lambda_{ij}s_j = 0$  and  $\lim_{t \rightarrow \infty} \mu_i X_i = 0$ . Note that (60) imply that solutions  $\lambda_{ij} = \mu_i = 0$  are admissible at all times. Using them and imposing symmetry across outputs and  $\lambda_{ii}$ 's, (58) is solved by  $q^{CN} = (A + \lambda\nu) / (n + 1)$ , which, in turn, delivers  $\dot{q} = \lambda\nu / (n + 1)$ . This, on the basis of (59-60), becomes

$$\dot{q} = \frac{(\eta + \rho)[(n + 1)q - A] + \tau\nu}{n + 1} \quad (61)$$

The steady state values of the  $n + 1$  states and the single control are

$$\begin{aligned} \hat{s} &= \frac{\nu[A(\eta + \rho) - \nu\tau]}{(n + 1)\eta(\eta + \rho)} = \frac{\nu}{\eta}\hat{q}; \\ \hat{X}_{\pm} &= \frac{(n + 1)\delta(\eta + \rho) \pm \sqrt{\Theta}}{2(n + 1)\beta\delta(\eta + \rho)}; \hat{q} = \frac{A(\eta + \rho) - \nu\tau}{(n + 1)(\eta + \rho)} \end{aligned} \quad (62)$$

where  $\Theta \equiv (n + 1)^2\delta^2(\eta + \rho)^2 + 4(n + 1)\delta(\eta + \rho)n\beta\gamma[\nu\tau - A(\eta + \rho)]$ , and  $\hat{q} > 0$  implies  $\hat{X}_+ \geq \hat{X}_- > 0$ .

Standard stability analysis (assuming  $\lambda_{ij} = 0$  and  $\mu_i = 0$  for all  $t$ ) of the equilibrium implies two strictly positive and one negative eigenvalue for both steady state values of  $X$ . The fourth eigenvalue is negative for  $\hat{X}_+$  and positive for  $\hat{X}_-$ . Both equilibria are saddle points but only  $\hat{X}_+$  is a candidate for an optimal solution.

Regulating access to the commons to ensure  $\hat{X}_+ = X_{MSY} = 1 / (2\beta)$  requires imposing

$$n = n_{MSY} \equiv \frac{\delta(\eta + \rho)}{4\beta\gamma[A(\eta + \rho) - \nu\tau] - \delta(\eta + \rho)} \quad (63)$$

## A.3 Proof of Proposition 7

Posing  $\mu_i = 0$  and  $\lambda_{ij} = 0$  for all  $j \neq i$  at all times, and imposing symmetry, we may solve (15) to obtain  $k = -\phi\lambda / (2b)$  and thus also  $\dot{k} = -\phi\dot{\lambda} / (2b)$ , in such a way that control equations are

$\dot{k} = -\phi[\lambda(\eta + \rho) + \tau]/(2b)$  and  $\dot{q} = \nu[\lambda(\eta + \rho) + \tau]/(n + 1)$ , which are not linearly independent. Consequently, we use FOC (58) to identify the Cournot output, and (15) to identify the expression of the shadow price,  $\lambda = -2bk/\phi$ , thereby obtaining

$$\begin{aligned} \dot{k} &= k(\eta + \rho) - \frac{\phi\tau}{2b} \\ A - (n + 1)q - \frac{2b\nu k}{\phi} &= 0 \\ \dot{s} &= \nu q - \eta s - \phi k \\ \dot{X} &= \delta X(1 - \beta X) - \gamma(n - 1)q \end{aligned} \quad (64)$$

Imposing stationarity, we have

$$\begin{aligned} \hat{k} &= \frac{\phi\tau}{2b(\eta + \rho)}; \hat{q} = \frac{A(\eta + \rho) - \nu\tau}{(n + 1)(\eta + \rho)} \\ \hat{s} &= \frac{\nu\hat{q} - \phi\hat{k}}{\eta}; \hat{X}_{\pm} = \frac{\delta \pm \sqrt{\Psi}}{2\beta\delta} \end{aligned} \quad (65)$$

where  $\Psi \equiv \delta[(\eta + \rho)(\delta + n(\delta - 4A\beta\gamma)) + 4n\beta\gamma\nu\tau]/[(n + 1)(\eta + \rho)]$ . At this point we may follow the same procedure as in the previous setting, by noting that the stable solution for the resource stock is necessarily  $\hat{X}_+$ , and impose  $\hat{X}_+ = 1/(2\beta)$  to find

$$n_{MSY}(\tau) = \frac{\delta(\eta + \rho)}{(\eta + \rho)(4A\beta\gamma - \delta) - 4\beta\gamma\nu\tau} \geq 1 \quad (66)$$

for all  $A \in ([\delta(\eta + \rho) + 4\beta\gamma\nu\tau]/[4\beta\gamma(\eta + \rho)], [\delta(\eta + \rho) + 2\beta\gamma\nu\tau]/[2\beta\gamma(\eta + \rho)])$ . At  $n = n_{MSY}(\tau)$ , once again  $\hat{Q}(n_{MSY}(\tau)) = \delta/(4\beta\gamma)$ , and  $\widehat{CS}(n_{MSY}(\tau)) = \delta^2/(32\beta^2\gamma^2)$ , the reason being that this happens for any tax rate, and therefore this result applies even in correspondence of a tax designed to bring emissions to zero (or any other targeted level). The corresponding environmental damage is

$$\widehat{D}(n_{MSY}(\tau)) = \frac{\zeta [b\delta\nu((4A\beta\gamma - \delta)(\eta + \rho) - 4\beta\gamma\nu\tau) - 2\beta\gamma\delta\phi^2\tau]^2}{16b^2\beta^2\gamma^2\eta^2 [(4A\beta\gamma - \delta)(\eta + \rho) - 4\beta\gamma\nu\tau]^2} \quad (67)$$

This expression is nil at

$$\tau^* = \frac{b\nu(4A\beta\gamma - \delta)(\eta + \rho)}{2\beta\gamma(2b\nu^2 + \phi^2)} > 0 \quad (68)$$

which obviously solves  $\partial\widehat{D}(n_{MSY}(\tau))/\partial\tau = 0$ . Of course, adopting of  $\tau^*$  implies  $\widehat{s}(n_{MSY}) = 0$ .

#### A.4 Proof of Proposition 10

The FOC on  $q_i$  is

$$A - 2(d + \xi)q_i - \sigma \sum_{j \neq i} q_j + \lambda_{ii}\nu - \mu_i\gamma = 0 \quad (69)$$

yielding  $\lambda_{ii} = [2(d + \xi)q_i + \sigma \sum_{j \neq i} q_j + \mu_i\gamma - A]/\nu$ , while transversality conditions and costate equations are the same as those associated with (19). The game remains state-redundant w.r.t.  $X$

and its open-loop solution is strongly time consistent. Hence, after imposing symmetry across controls and  $\lambda_{ij} = \mu_i = 0$ , we have

$$q^{CN} = \frac{A + \lambda\nu}{2(d + \xi) + \sigma(n + 1)} \Rightarrow \dot{q}^{CN} = \frac{\lambda\nu}{2(d + \xi) + \sigma(n + 1)} \quad (70)$$

which can be explicitly written as follows:

$$\dot{q}^{CN} = \frac{(\eta + \rho) [(2(d + \xi) + \sigma(n + 1))q - A] + \tau\nu}{n + 1} \quad (71)$$

This, together with the  $n + 1$  state equations (1-2) forms the state-control system of the present formulation of the game. The coordinates of steady state points are (stability can be verified proceeding as in section 3)

$$\begin{aligned} \hat{s}^{CN} &= \frac{\nu [A(\eta + \rho) - \nu\tau]}{\eta(\eta + \rho) [2(d + \xi) + \sigma(n + 1)]} = \frac{\nu}{\eta} \hat{q} \\ \hat{X}_{\pm}^{CN} &= \frac{\delta(\eta + \rho) (2(d + \xi) + \sigma(n + 1)) \pm \sqrt{\Phi}}{2\beta\delta(\eta + \rho) [2(d + \xi) + \sigma(n + 1)]} \\ \hat{q}^{CN} &= \frac{A(\eta + \rho) - \nu\tau}{(\eta + \rho) [2(d + \xi) + \sigma(n + 1)]} \end{aligned} \quad (72)$$

where

$$\begin{aligned} \Phi &\equiv \delta(\eta + \rho) [2(d + \xi) + \sigma(n + 1)] \times \\ &[(\eta + \rho) (\delta(2(d + \xi) + \sigma(n + 1)) - 4An\beta\gamma) + 4n\beta\gamma\nu\tau] \end{aligned} \quad (73)$$

which obviously coincide with  $\Theta$  iff  $d = 0$  and  $\sigma = \xi = 1$ . If this is not true, then imposing harvesting at the *MSY* implies that the resulting expression identifying the number of firms being granted access to the common pool will contain demand parameters (as well as  $\tau$ , of course), and this will necessarily affect the individual firm's equilibrium price in such a way that the sum of the traditional components of welfare (profits and consumer surplus) will not be independent of the emission tax. The number of firms ensuring the industry harvest at the maximum sustainable yield is

$$n_{MSY}^{CN} = \frac{\delta(\eta + \rho) [2(d + \xi) - \sigma]}{(\eta + \rho) (4A\beta\gamma - \delta\sigma) - 4\beta\gamma\nu\tau} \quad (74)$$

which, just like  $n_{MSY}$ , is monotonically increasing in the tax rate  $\tau$ . Intuitively, it is also increasing in  $d$ , as this parameter determines the slope of the convex component of production costs. It can be easily checked that  $n_{MSY}^{CN}$  is positive and at least equal to one for all

$$A \in \left( \frac{\delta(\eta + \rho)\sigma + 4\beta\gamma\nu\tau}{4\beta\gamma(\eta + \rho)}, \frac{(d + \xi)\delta(\eta + \rho) + 2\beta\gamma\nu\tau}{2\beta\gamma(\eta + \rho)} \right) \quad (75)$$

Now, if  $n = n_{MSY}^{CN}$  and therefore  $\hat{X} = 1/(2\beta)$ , the remaining equilibrium expressions of the relevant magnitudes look as follows:

$$\hat{Q}^{CN}(n_{MSY}(\tau)) = \frac{\delta}{4\beta\delta}; \hat{D}^{CN}(n_{MSY}(\tau)) = \frac{\delta^2\nu^2\zeta}{16\beta^2\gamma^2\eta^2} \quad (76)$$

i.e., the same as in section 3, while<sup>13</sup>

$$n_{MSY}^{CN} \widehat{\pi}^{CN}(n_{MSY}(\tau)) + \widehat{CS}^{CN}(n_{MSY}(\tau)) + n_{MSY}^{CN} \tau \widehat{s}^{CN}(n_{MSY}(\tau)) = \quad (77)$$

$$\frac{\delta [4A\beta\gamma(\eta + \rho)(2d + 3\xi - \sigma) - \delta\xi\sigma(\eta + \rho) + 4\beta\gamma\nu(2d + \xi - \sigma)\tau]}{32\beta^2\gamma^2(\eta + \rho)[2(d + \xi) - \sigma]}$$

clearly illustrates that  $\tau$  plays a purely redistributive role, and the traditional part of social welfare is independent of emission taxation at equilibrium iff  $d = 0$  and  $\xi = \sigma$ .

### A.5 Proof of Proposition 11

Given additive separability, the FOCs taken w.r.t.  $k_i(t)$  and  $q_i(t)$  are (15) and (69), respectively. The two control equations being not linearly independent, we must solve the system

$$\begin{aligned} \dot{k} &= k(\eta + \rho) - \frac{\phi\tau}{2b} \\ A - [2(d + \xi) + \sigma(n - 1)]q - \frac{2b\nu k}{\phi} &= 0 \\ \dot{s} &= \nu q - \eta s - \phi k \\ \dot{X} &= \delta X(1 - \beta X) - \gamma(n - 1)q \end{aligned} \quad (78)$$

made up by the control equation of the abatement effort, the FOC on the output level, and the state equations. Doing so, we obtain

$$\begin{aligned} \widehat{k}^{CN} &= \frac{\phi\tau}{2b(\eta + \rho)}; \widehat{q}^{CN} = \frac{A(\eta + \rho) - \nu\tau}{(\eta + \rho)[2(d + \xi) + \sigma(n - 1)]} \\ \widehat{s}^{CN} &= \frac{\nu\widehat{q}^{CN} - \phi\widehat{k}^{CN}}{\eta}; \widehat{X}_{\pm}^{CN} = \frac{\delta \pm \sqrt{\Lambda}}{2\beta\delta} \end{aligned} \quad (79)$$

where  $\widehat{X}_{+}^{CN}$  is stable, and  $\Lambda \equiv \delta\delta - 4n\beta\gamma(A(\eta + \rho) - \nu\tau) / [(\eta + \rho)(2(d + \xi) + \sigma(n - 1))]$ , which coincides with  $\Psi$  iff  $d = 0$  and  $\xi = \sigma = 1$ .

The number of firms at which harvest takes place in correspondence of the  $MSY$  is  $n_{MSY}^{CN}(\tau)$ , i.e., the same as in (74). If  $n = n_{MSY}^{CN}(\tau)$ , the total abatement effort at the industry level is

$$\widehat{K}^{CN}(n_{MSY}^{CN}(\tau)) = \frac{\delta\phi[2(d + \xi) - \sigma]\tau}{2b[(4A\beta\gamma - \delta\sigma)(\eta + \rho) - 4\beta\gamma\nu\tau]} \quad (80)$$

which is monotonically increasing in  $\tau$  in the admissible parameter range. Moreover, as in section 3.1, the equilibrium amount of the environmental damage is not independent of the emission tax,

$$\widehat{D}^{CN}(n_{MSY}(\tau)) = \frac{\zeta [b\delta\nu((4A\beta\gamma - \delta\sigma)(\eta + \rho) - 4\beta\gamma\nu\tau) - 2\beta\gamma\delta(2(d + \xi) - \sigma)\phi^2\tau]^2}{16b^2\beta^2\gamma^2\eta^2[(4A\beta\gamma - \delta\sigma)(\eta + \rho) - 4\beta\gamma\nu\tau]^2} \quad (81)$$

This expression is nil at

$$\tau^{CN} = \frac{b\nu(4A\beta\gamma - \delta\sigma)(\eta + \rho)}{2\beta\gamma[2b\nu^2 + (2(d + \xi) - \sigma)\phi^2]} > 0 \quad (82)$$

<sup>13</sup>In this case, due to the presence of imperfect product substitutability, consumer surplus is defined as  $CS = [\sum_{i=1}^n (a - p_i)q_i] / 2$  (cf., Ottaviano *et al.*, 2002; Cellini *et al.*, 2004, *inter alia*).

and of course the latter also solves  $\partial \widehat{D}^{CN} (n_{MSY}^{CN}(\tau)) / \partial \tau = 0$ . Intuitively, (82) coincides with (68) for  $d = 0$  and  $\xi = \sigma = 1$ . Finally, if  $\tau = \tau^{CN}$ , then  $K^{CN} (n_{MSY}^{CN}(\tau^{CN})) = \delta\nu / (4\beta\gamma\phi)$  is independent of differentiation and the shape of production costs.

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