

Do Environment Protection Incentives Reduce Investment Uncertainty?

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Keywords: Environment, Protection, Incentives, Sustainability, Investment, Uncertainty, Game Theory, Signaling, Labels, Subsidization, Monitoring

Abstract. This paper uses a game theoretic approach to evaluate the effectiveness of different environment protection incentives with regard to the willingness of firms to engage in ecological production and related investment uncertainty. In case of eco-labels, asymmetric information between firms and consumers gives firms the opportunity to cheat and label their products without engaging in ecological production. Hence, there is no equilibrium where ecological goods are produced and labelled truthfully in a non-repeated game. Third party monitoring can improve the situation and allow for an eco-friendly equilibrium under certain conditions. Consumer awareness and credible signals play a crucial role in this setting. The importance of consumer awareness is even more evident when environment protection incentives are based on consumer commitment. Subsidies as another form of environment protection incentives are not likely to reduce investment uncertainty unless governments have strong incentives to gain a reputation of credibility.