

ECN 371: Exercise set 4

Exercise sets are not to be handed in. At the same time as exercises are put on the WEB page, so are the associated suggestions for answers.

In a country there are two rivers, one with a highly valuable fishery, and the other without any extra environmental value (besides the ordinary). Located by each of the rivers, there are three paper mills, each mill producing a special quality paper for a limited (niche) market, using similar production technologies. Together the mills cover a large share of the market supply of this quality paper.

While being concerned about the environment, the government also worries about international competitiveness. Hence, it has hired in a private consulting firm, Quick & Dirty Ltd.

The main points in the recommendations of Quick & Dirty are:

- making a joint market for tradable emission permits in the two rivers, and
- grandfathering out permits to firms of approximately 50% of current emissions.

Being an expert in environmental economics, you are called in as an external reviewer to comment on the recommendations of Quick & Dirty.

- (a) What specific problems, if any, do you see with Quick & Dirty's recommendations? Justify your answer.
- (b) What policy changes, if any, would you suggest? Justify your answer.