

Econ 581
Midterm
Spring 2010

Part I (20 points each): Indicate whether the following statements are true or false and explain why. Points will be given for the explanation of your answer only. Write your answers as **completely** as possible.

1. The imposition of a Pigouvian tax to correct for environmental externalities yields greater benefits when there are pre-existing distortionary labor taxes compared to when no distortionary taxes are present.

2. There are no circumstances under which the initial allocation of permits in a marketable permit system will have consequences for the distribution of permits (and therefore emissions) after trading has occurred.

Part II (20 points each: Provide the requested information for each of the following questions.

1. Describe how *safety valves* and *allowance reserves* help to reduce potential welfare losses arising from the regulator's uncertainty (or simply mistakes) about the cost of abatement.

2. List three distinct economic rationale for auctioning permits rather than assigning them to existing firms based on historical emissions. (Hint: Think back to the various potential problems we considered in implementing the alternative regulator mechanism; e.g., Pigouvian taxes, tradeable permits, etc.)

3. The *Stern Review on the Economics of Climate Change* provided a prescription for dealing with concerns about climate change. Summarize briefly the basic conclusions of the report and identify the key criticism leveled against the *Stern Review* by Mendelsohn and Weyant.