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Abstract

Markets for pollution have become a popular regulatory instrument. In this article we investigate the implications of strategic trade in pollution permits. The permit market is developed as a strategic market game, where all firms are allowed to behave strategically and their roles as buyers or sellers of permits are determined endogenously with price-mediated trade. In a second stage, firms transact on a product market and we allow for a variety of market structures. We identify a unique equilibrium in permit exchange, investigate the properties of this equilibrium, and consider the effect of strategic behavior in the product market.

Key words: Pollution market, Market power, Strategic market game.

JEL classification: D43, Q52.

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