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Author: Barbara Annicchiarico Luca Correani Fabio Di Dio

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Environmental Policy and Endogenous Market Structure*

Barbara Annicchiarico† Luca Correani‡ Fabio Di Dio§

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Abstract

This paper presents a simple dynamic general equilibrium model with supply-side strategic interactions to study the economic effects of mitigating greenhouse gas emissions in an economy with an emission cap and oligopolistic firms competing on prices. With such endogenous market structure a gradual decarbonization policy is likely to induce higher markups, while the number of active firms displays a U-shaped behavior, first decreasing and then increasing. In the long run more firms are active, but they transfer a part of the compliance cost to households by charging a higher markup. The negative effects on the level of economic activity of this anti-competitive outcome are strongly mitigated by recycling policies.

Keywords: *Environmental Policy, Dynamic General Equilibrium Model, Endogenous Market Structure.*
JEL codes: E60, Q54, Q58.

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†*Corresponding author*: Dipartimento di Economia e Finanza, Università degli Studi di Roma Tor Vergata, Via Columbia 2, 00133 Roma - Italy; e-mail: barbara.annicchiarico@uniroma2.it.

‡Dipartimento di Economia e Impresa, Università degli Studi della Tuscia; e-mail: correani@unitus.it.

§Sogei S.p.a. - IT Economia - Modelli di Previsione ed Analisi Statistiche; e-mail: fdidio@sogei.it.

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