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Letters

Permit auction will not affect prices

From Prof Paul Klemperer.

Sir, You quoted me as suggesting that auctioning greenhouse gas emissions permits could raise "perhaps £4bn to £5bn a year" for the UK Treasury ("Environmentalists sticks to guns", May 31). This figure applies if almost all the UK's allocation of permits are auctioned. If only the permits needed by the electricity generators are auctioned, the annual amount is likely to be around £2bn (based on current carbon prices).

More important than the exact numbers, however, is the contention that auctioning might affect consumer prices. The truth is that *any* system of emissions permits will raise prices. But whether they are given out free, or through auctions, will make *no* difference to consumer prices.

The rent you pay your landlord is the same whether he had to buy the house at a high price, or whether he inherited it – he will charge the

market price either way. And the price companies charge for electricity will be the same whether they buy the permits at auction, or receive them free. In either case, the market price for electricity will rise to reflect the market price of the permits (which is also independent of whether they are originally given away free, or auctioned).

Furthermore, this price rise automatically compensates the companies for the costs of the permits – giving out the permits free therefore hands out windfall profits to companies by compensating them twice over. This explains why, as you write in another article on the same page ("Fuel poverty relief plan draws fire"), energy suppliers are now making "£9bn profit from the emissions trading scheme".

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