46/2008 A.2.2.1

Raport Badawczy
Research Report

RB/17/2008

Compliance and emission trading rules for nonsymmetric emission uncertainty estimates

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Warszawa 2008

An addendum to the paper "Compliance and emission trading rules for nonsymmetric emission uncertainty estimates"

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Abstract. This note contains a prove of the expression for the efficient emission with fuzzy nonsymmetric distributions in the paper (Nahorski & Horabik, 2009) and is an appendix to this paper. It includes some technical derivations, which place outside the main paper acoording to the rules of the *Climate Policy* editors.

Keywords: greenhouse gases emission inventories, uncertainty, fuzzy sets, emission permit trading.

1. Derivation of the expression for the efficient emission with fuzzy nonsymmetric distributions

From equation (27) of the paper (Nahorski & Horabik, 2009) repeated below for convenience

$$\hat{x}_c + \left\{1 - \left[(1 + \frac{d_{bc}^l}{d_{bc}^u}\frac{1+\gamma_{bc}^u}{1+\gamma_{bc}^l})\alpha\right]^{\frac{1}{1+\gamma_{bc}^u}}\right\} d_{bc}^u \leq (1-\delta)\hat{x}_b \qquad (1)$$

the compliance condition of the buying party, after simple manipulation, is

$$\hat{x}_c^B + d_{bc}^{uB} - \left[\left((d_{bc}^{uB})^{1+\gamma_{bc}^{uB}} + (d_{bc}^{uB})^{\gamma_{bc}^{uB}} d_{bc}^{lB}\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}\right)\alpha\right]^{\frac{1}{1+\gamma_{bc}^{uB}}} \leq (1-\delta^B)\hat{x}_b^B$$

After buying $\hat{E}$ emission units from the selling party, the compliance condition becomes

$$\hat{x}_c^B - \hat{E}^S + d_{bc}^{uB} + \hat{E}^S R_c^{uS} - \left[\left((d_{bc}^{uB} + \hat{E}^S R_c^{uS})^{1+\gamma_{bc}^{uB}} + \right.\right.$$

$$\left.\left.(d_{bc}^{uB} + \hat{E}^S R_c^{uS})^{\gamma_{bc}^{uB}}(d_{bc}^{lB} + \hat{E}^S R_c^{lS})\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}\right)\alpha\right]^{\frac{1}{1+\gamma_{bc}^{uB}}} \leq$$

$$\leq (1-\delta^B)\hat{x}_b^B \qquad (2)$$

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In approximations used in the sequel the following approximate equation will be applied

$$(1+x)^{\xi} \approx 1+\xi x \tag{3}$$

which can be easily obtained from the first order Taylor series expansion of the left hand side. Good approximations are obtained for $|x| << 1$.

Let us consider the expression in the square brackets in equation (2). Applying (3) we get

$$(d_{bc}^{uB}+\hat{E}^{S}R_{c}^{uS})^{1+\gamma_{bc}^{uB}} = (d_{bc}^{uB})^{1+\gamma_{bc}^{uB}}(1+\frac{\hat{E}^{S}R_{c}^{uS}}{d_{bc}^{uB}})^{1+\gamma_{bc}^{uB}} \approx$$

$$\approx (d_{bc}^{uB})^{1+\gamma_{bc}^{uB}}(1+(1+\gamma_{bc}^{uB})\frac{\hat{E}^{S}R_{c}^{uS}}{d_{bc}^{uB}})$$

and similarly

$$(d_{bc}^{uB}+\hat{E}^{S}R_{c}^{uS})^{\gamma_{bc}^{uB}} \approx (d_{bc}^{uB})^{\gamma_{bc}^{uB}}(1+\gamma_{bc}^{uB}\frac{\hat{E}^{S}R_{C}^{uS}}{d_{bc}^{uB}})$$

Let us notice that $\frac{\hat{E}^{S}R_{c}^{uS}}{d_{bc}^{uB}} = \frac{\hat{E}^{S}d_{c}^{uS}}{\hat{x}_{c}d_{bc}^{uB}}$. As we can expect that the emission sold will be much smaller than that emitted by the selling party, then $\frac{\hat{E}^{S}}{\hat{x}_{c}} << 1$, and therefore approximation should be good. Thus, dropping the expressions with the squares of $\frac{\hat{E}^{S}}{\hat{x}_{c}}$ we can transform the expression in the square brackets in (2) to

$$(d_{bc}^{uB})^{1+\gamma_{bc}^{uB}}(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}})+$$

$$+(1+\gamma_{bc}^{uB})\hat{E}^{S}R_{c}^{uS}(d_{bc}^{uB})^{\gamma_{bc}^{uB}}\Big(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}+\frac{R_{c}^{lS}}{R_{c}^{uS}}\frac{1}{1+\gamma_{bc}^{lB}}\Big)$$

and then to

$$(d_{bc}^{uB})^{1+\gamma_{bc}^{uB}}(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}})\times$$

$$\times\Big(1+(1+\gamma_{bc}^{uB})\hat{E}^{S}R_{c}^{uS}\frac{1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}+\frac{d_{c}^{lS}}{d_{c}^{uS}}\frac{1}{1+\gamma_{bc}^{lB}}}{d_{bc}^{uB}(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}})}\Big)$$

Now, raising above to the power $\frac{1}{1+\gamma_{bc}^{uB}}$ and using (3) we get

$$d_{bc}^{uB}(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}})^{\frac{1}{1+\gamma_{bc}^{uB}}}\times$$

$$\times\Big(1+\hat{E}^S R_c^{uS}\frac{1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}+\frac{d_c^{lS}}{d_c^{uS}}\frac{1}{1+\gamma_{bc}^{lB}}}{d_{bc}^{uB}(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}})}\Big)=$$

$$=d_{bc}^{uB}(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}})^{\frac{1}{1+\gamma_{bc}^{uB}}}+$$

$$+\hat{E}^S R_c^{uS}\Big(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}+\frac{d_c^{lS}}{d_c^{uS}}\frac{1}{1+\gamma_{bc}^{lB}}\Big)\Big(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}\Big)^{-\frac{\gamma_{bc}^{uB}}{1+\gamma_{bc}^{uB}}}$$

The last but one term can be transformed as follows

$$\Big(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}+\frac{d_c^{lS}}{d_c^{uS}}\frac{1}{1+\gamma_{bc}^{lB}}\Big)\approx\Big(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}\Big)\Big(1+\frac{d_c^{lS}}{d_c^{uS}}\frac{1}{1+\gamma_{bc}^{lB}}\Big)\approx$$

$$\approx\Big(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\Big)^{\frac{\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}}\Big(1+\frac{d_c^{lS}}{d_c^{uS}}\Big)^{\frac{1}{1+\gamma_{bc}^{lB}}}$$

and similarly the last term

$$\Big(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}\Big)^{-\frac{\gamma_{bc}^{uB}}{1+\gamma_{bc}^{uB}}}\approx\Big(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\Big)^{-\frac{\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}}}$$

Finally, the expression in the brackets in (2) approximately equals to

$$d_{bc}^{uB}(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}})^{\frac{1}{1+\gamma_{bc}^{uB}}}+\hat{E}^S R_c^{uS}\Big(1+\frac{d_c^{lS}}{d_c^{uS}}\Big)^{\frac{1}{1+\gamma_{bc}^{lB}}}$$

Quality of approximations above depend on the ratios $\frac{d_{bc}^{lB}}{d_{bc}^{uB}}$ and $\frac{d_c^{lS}}{d_c^{uS}}$. When they are small, the approximation is good. When they are close to 1, the approximation should be worse. The final formula (5) is, however, also true for $\frac{d_c^{lS}}{d_c^{uS}}=1$, as can be seen from an independent derivation of (??). This may suggest that actually the formula (5) might be perhaps derived without using approximation (3), at least in the final part of the derivation.

Thus, condition (2) can be approximately written as

$$\hat{x}_c^B-\hat{E}^S+d_{bc}^{uB}+\hat{E}^S R_c^{uS}-d_{bc}^{uB}\Big[(1+\frac{d_{bc}^{lB}}{d_{bc}^{uB}}\frac{1+\gamma_{bc}^{uB}}{1+\gamma_{bc}^{lB}})\alpha\Big]^{\frac{1}{1+\gamma_{bc}^{uB}}}-$$

$$-\hat{E}^S R_c^{uS}\Big[\Big(1+\frac{d_c^{lS}}{d_c^{uS}}\Big)\alpha\Big]^{\frac{1}{1+\gamma_{bc}^{lB}}}\le(1-\delta^B)\hat{x}_b^B \qquad (4)$$

Comparing (4) with (1) we find the difference

$$E_{eff} = \hat{E}^S \Big\{ 1 - \{ 1 - \hat{E}^S R_c^{uS} \Big[\Big(1 + \frac{d_c^{\bar{S}}}{d_c^{u\bar{S}}} \Big) \alpha \Big]^{\frac{1}{1+\gamma_{bc}^{IE}}} \} R_c^{uS} \Big\} \qquad (5)$$

which is exactly equation (29) of the paper ((Nahorski & Horabik, 2009)).

References

Nahorski Z, Horabik J (2009) Compliance and emission trading rules for nonsymmetric emission uncertainty estimates, *Climatic Change*, submitted.