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Working Paper
Integrating Bottom-Up into Top-Down: A Mixed Complementarity Approach

ZEW Discussion Papers, No. 05-28

Provided in Cooperation with:
ZEW - Zentrum für Europäische Wirtschaftsforschung / Center for European Economic Research

Suggested Citation: Böhringer, Christoph; Rutherford, Thomas F. (2005): Integrating Bottom-Up into Top-Down: A Mixed Complementarity Approach, ZEW Discussion Papers, No. 05-28, Zentrum für Europäische Wirtschaftsforschung (ZEW), Mannheim

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Nontechnical Summary

In applied energy policy analysis there is a commonly perceived dichotomy between bottom-up models of the energy system and top-down models of the overall economy. Bottom-up models provide a detailed description of the energy system from primary energy processing via multiple conversion, transport, and distribution processes to final energy use but neglect interactions with the rest of the economy. Furthermore, the formulation of such models as mathematical programs restricts their direct applicability to integrable equilibrium problems; many interesting policy problems involving initial inefficiencies can therefore not be handled directly. Top-down economy-wide models on the other hand are able to capture market interactions and inefficiencies in a comprehensive manner but typically lack technological details that might be relevant for the policy issue at hand.

In this paper, we motivate the formulation of market equilibria as a mixed complementarity problem (MCP) in order to bridge the gap between bottom-up and top-down analysis. Through the explicit representation of weak inequalities and complementarity between decision variables and functional relationships, the MCP approach allows to exploit the advantages of each model type – technological details of bottom-up models and economic richness of top-down models – in a single mathematical format.

We demonstrate the integration of bottom-up into top-down along a simple stylized example and present illustrative policy simulations with our integrated model on central energy policy issues including green quotas, nuclear phase-out, and carbon taxation. Together with an explicit algebraic representation, we provide the computer programs for the replication of simulation results. The latter may serve as a starting point for further – more elaborate – applications by the interested reader.
Integrating Bottom-Up into Top-Down: 
A Mixed Complementarity Approach

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Abstract

We motivate the formulation of market equilibria as a mixed complementarity problem (MCP) in order to bridge the gap between bottom-up energy system models and top-down general equilibrium models for energy policy analysis. Our objective is primarily pedagogic. We first lay out that the MCP approach provides an explicit representation of weak inequalities and complementarity between decision variables and market equilibrium conditions. This permits us to combine bottom-up technological details and top-down economic richness in a single mathematical format. We then provide a stylized example of how to integrate bottom-up features into a top-down modeling framework along with worked examples and computer programs which illustrate our approach.

JEL classification: C61, C68, D58, Q43

Keywords: Energy Policy, Computable General Equilibrium, Bottom-Up, Top-Down
1 Introduction

There are two wide-spread modeling approaches for the quantitative assessment of economic impacts induced by energy policies: bottom-up energy system models and top-down models of the broader economy. The two model classes differ mainly with respect to the emphasis placed on technological details of the energy system vis-à-vis the comprehensiveness of endogenous market adjustments.

Bottom-up energy system models are partial equilibrium representations of the energy sector. They feature a larger number of discrete energy technologies to capture substitution of energy carriers on the primary and final energy level, process substitution, process (efficiency) improvements, or energy savings but omit interaction with the rest of the economy. These models are typically cast as optimization problems that compute the least-cost combination of energy system activities to meet a given demand for final energy or energy services subject to technical restrictions and energy policy constraints.

Top-down models adopt a broader economic framework taking into account interaction and spillover effects between markets as well as income effects for various economic agents such as private households or the government. The high degree of endogeneity in economic responses to policy shocks typically goes at the expense of specific sectoral or technological detail. As a matter of fact, conventional top-down models of energy-economy interactions have a very skimpy representation of the energy system: Energy transformation processes are represented by smooth production functions which capture abstract substitution (transformation) possibilities through constant elasticities of substitution (transformation). Consequently, top-down models usually lack detail on current and future technological options which may be relevant for an appropriate assessment of specific energy policy proposals.\(^1\)

The specific strengths and weaknesses of the bottom-up and top-down framework explain continuous hybrid modeling efforts that combine technological explicitness of bottom-up models with the economic richness of top-down models. There are three major approaches to hybridizing: First, existing – independently developed – bottom-up and top-down models can be linked. This approach has been adopted since the early 1970ies (see e.g. Hofman and Jorgenson [1976], Hogan and Weyant [1982], or Messner and Strubegger [1987]) but often challenges overall coherence due to inconsistencies in behavioral assumptions and accounting concepts of "soft-linked" models. Second, one could focus on one model type – either bottom-up or top-down – and use "reduced form" representations of the other. A prominent example along this line is ETA-Macro (Manne [1977]) which links a detailed bottom-up energy system model with a highly aggregate one-sector macro-economic model of production and consumption within a single optimization framework.\(^2\) The third approach provides

\(^1\)In addition, top-down models may not assure fundamental physical restrictions such as the conservation of matter and energy.

\(^2\)More recent hybrid modelling approaches based on the same technique include Bahn et al. [1999] or Messner and Schrattenholzer [2000].
completely integrated models (see e.g. Böhringer [1998]) based on developments of solution algorithms for mixed complementarity problems during the mid90ies (Dirkse and Ferris [1995], Rutherford [1995]).

In this paper, we focus on the integrated mixed complementarity approach which stands out for the coherence and logical appeal to bridging the gap between conventional bottom-up energy system models and top-down computable general equilibrium (CGE) models for energy policy analysis. Apart from accommodating discrete activity analysis with respect to alternative technological options in an economy-wide framework, the mixed complementarity approach relaxes so-called "integrability" conditions that are inherent to bottom-up models or integrated system models formulated as optimization problem. In applied energy policy analysis it is often overlooked that optimization problems are only equivalent to economic market equilibrium problems subject to integrability conditions that imply efficient allocation (Pressman [1970] or Takayma and Judge [1971]). Since many interesting economic problems are associated with non-integrable second-best situations (due to ad-valorem taxes, institutional price constraints, or spillover externalities), the optimization approach to integrate bottom-up and top-down is relatively limited in the scope of policy applications.

Our objective is primarily pedagogic. We start by motivating the formulation of market equilibria as a mixed complementarity problem (MCP). The MCP formulation explicitly features weak inequalities and complementarity between decision variables and market equilibrium conditions: This permits the modeler to combine the advantages of bottom-up technological details and top-down economic richness in a single mathematical format. We then lay out the integration of a stylized bottom-up representation for electricity generation into a simple top-down description of the wider economy. Finally, we present illustrative policy simulations with our integrated model on central energy policy issues including green quotas, nuclear phase-out, or carbon taxation. Along with an algebraic representation, we provide the computer programs for the replication of simulation results. The latter may serve as a potential starting point for further more elaborate applied analysis by the interested reader.

3Apart from CGE models that adopt the (neoclassical) microeconomic rationale, top-down approaches may also include aggregate demand-driven Keynesian models which typically put more emphasis on macroeconomic phenomena and econometric foundations (see Weyant and Olavson [1999]).

4"Non-integrabilities" furthermore reflect empirical evidence that individual demand functions depend not only on prices but also on the initial endowments. In such cases, demand functions are typically not "integrable" into an economy-wide utility function (see e.g. Chipman [1974]): Only if the matrix of cross-price elasticities (i.e. the first-order partial derivatives of the demand functions) be symmetric, is there an associated optimization problem which can be used to compute the equilibrium prices and quantities.


2 Mixed Complementarity Formulation of Market Equilibria

We consider a competitive (Arrow-Debreu) economy with \( n \) commodities (incl. factors), \( m \) production activities (sectors), and \( h \) households. The decision variables of the economy can be classified into three categories (Mathiesen [1985]):

\( p \) is a non-negative \( n \)-vector (with running index \( i \)) in prices for all goods and factors

\( y \) denotes a non-negative \( m \)-vector (with running index \( j \)) for activity levels of constant-returns-to-scale (CRTS) production sectors, and

\( M \) represents a non-negative \( k \)-vector (with running index \( h \)) in incomes.

A competitive market equilibrium is characterized by a non-negative vector of activity levels \((y \geq 0)\), a non-negative vector of prices \((p \geq 0)\), and a non-negative vector of incomes \((M \geq 0)\) such that:

- No production activity makes a positive profit (zero-profit condition), i.e.:
  \[
  -\Pi_j(p) = -a_j^T(p)p \geq 0
  \]
  where:
  \( \Pi_j(p) \) denotes the unit profit function for CRTS production activity \( j \), which is calculated as the difference between unit revenue and unit cost, and
  \( a_j^T(p) \) is the price-dependent technology vector for activity \( j \) which by – Hotelling’s Lemma – corresponds to the partial derivative \( \nabla \Pi_j(p) \).

- Excess supply (supply minus demand) is non-negative for all goods and factors (market clearance condition), i.e.:
  \[
  \sum_j y_j \nabla \Pi_j(p) + \sum_h w_h \geq \sum_h d_h(p, M_h)
  \]
  where:
  \( w_h \) indicates the initial endowment vector of household \( h \), and
  \( d_h(p, M_h) \) is the utility maximizing demand vector for household \( h \).

- Expenditure for household each \( h \) does not exceed income (budget constraint), i.e.:
  \[
  M_h = p^T w_h
  \]

Using Walras’ law, we can transform equilibrium conditions (1)-(3) to yield:

\[
 y_j \Pi_j(p) = 0
\]

\(^5\)Input coefficients have a negative sign; output coefficients are positive.
\[ p_i \left[ \sum_j (y_i \nabla \Pi_j (p) + \sum_h w_h) - \sum_h d_h (p, M_h) \right] = 0 \]  \hspace{1cm} (5)

\[ M_h (M_h - p^T w_h) = 0 \]  \hspace{1cm} (6)

Thus, economic equilibrium features complementarity between equilibrium variables and equilibrium conditions: (i) positive market prices imply market clearance, otherwise commodities are in excess supply and the respective prices fall to zero; (ii) activities will be operated as long as they break even, otherwise production activities are shut down; and (iii) income variables are linked to income budget constraints.

The complementarity features of economic equilibrium motivate the formulation of market equilibrium problems as a mixed complementarity problem (Rutherford [1995]):\(^6\)

Given \( f: \mathbb{R}^N \rightarrow \mathbb{R}^N \), \( l, u \in \mathbb{R}^N \)

Find \( z, w, v \in \mathbb{R}^N \)

subject to

\[ F(z) - w + v = 0 \]

\[ l \leq z \leq u, \ w \geq 0, \ v \geq 0, \]

\[ w^T (z - l) = 0, \ v^T (u - z) = 0 \]

We obtain the formulation of our market equilibrium as a mixed complementarity problem (MCP) by setting \( l = 0, \ u = +\infty, \ z = [y, p, M] \), and letting \( F(z) \) depict the equilibrium conditions (1)-(3). The MCP formulation provides a flexible framework for the integration of bottom-up activity analysis where alternative technologies \( t \) can produce the same output subject to technology-specific capacity constraints. As a concrete example, we may consider the standard linear planning problem to find a least-cost supply schedule for meeting an exogenous demand in energy good (service) \( j \):

\[ \min \sum_i \sum_t p_t a_{ijt} y_{jt} \]  \hspace{1cm} (7)

subject to

\[ \sum_t y_{jt} + \sum_{i \neq j} a_{ijt} y_i + \sum_h w_{hjt} \geq \sum_h d_{hj} \]

\[ y_{jt} \leq \sum_h w_{hjt} \]

where:

\(^6\)The term ”mixed complementarity problem” (MCP) reflects central features of this mathematical format: "mixed” indicates that the MCP formulation includes equalities as well as inequalities; ”complementarity” refers to complementary slackness between system variables and system conditions.
$y_{jt}$ is the activity level of technology $t$ producing energy good $j$,

$a_{ijt}$ denotes the (fixed) input coefficient for good $i$ of technology $t$ producing energy good $j$,

$\bar{d}_{jh}$ represents the exogenous demand by household $h$ for energy good $j$,

$\bar{y}_i$ is the exogenous level of non-energy production activity $i$, and

$w_{hjt}$ is the capacity of technology $t$ producing energy good $j$ which is owned by household $h$.

When we derive the Kuhn-Tucker conditions of the linear program, we obtain:

$$-(\sum_i a_{ijt}p_i + \lambda_{jt}) - \pi_j \geq 0, \quad y_{jt}, \quad y_{jt}[-(\sum_i a_{ijt}p_i + \lambda_{jt}) - \pi_j] = 0$$  \hspace{1cm} (8)

$$\sum_t y_{jt} + \sum_i a_{ji} \bar{y}_i + \sum_h w_{jh} \geq \sum_h \bar{d}_{jh}, \quad \pi_j, \pi_j (\sum_t y_{jt} + \sum_i a_{ji} \bar{y}_i + \sum_h w_{jh} - \sum_h \bar{d}_{jh}) = 0$$  \hspace{1cm} (9)

$$y_{jt} \leq \sum_h w_{hjt}, \quad \lambda_{jt}, \quad \lambda_{jt} (\sum_h w_{hjt} - y_{jt}) = 0$$  \hspace{1cm} (10)

where:

$\pi_j$ is the shadow price on the supply-demand balance for energy good $j$, and

$\lambda_{jt}$ is the shadow price on the capacity constraint for technology $t$ producing energy good $j$.

Comparing the Kuhn-Tucker conditions with the MCP formulation of our market equilibrium problem, we see that both are equivalent as the shadow prices of programming constraints coincide with market prices. The linear mathematical program can be readily interpreted as a special case of the general equilibrium problem where (i) income constraints are dropped, (ii) energy market demand of the non-energy system is exogenous, and (iii) energy supply technologies are characterized by fixed coefficients (rather than price-responsive coefficients). In turn, we can replace an aggregate top-down description of energy good production in the general equilibrium market setting with the Kuhn-Tucker conditions of the linear program which provides technological details.

Beyond the direct integration of bottom-up activity analysis, we can extend the MCP formulation of market equilibrium by adding explicit bounds on decisions variables such as prices or activity levels. Examples for price constraints may include lower bounds on the real wage or prescribed price caps on energy goods (upper bounds). As to quantity constraints, examples may include administered bounds on the share of specific energy sources (e.g. renewables or nuclear power) or target levels for the provision of public goods. Associated with these constraints, are complementary variables: In the case of price constraints, a rationing variable applies as soon as the price constraint becomes binding; in the case of quantity constraints, a complementary endogenous subsidy or tax is introduced.
3 Integration of Bottom-up into Top-Down: A Simple Maquette

In order to illustrate the MCP integration of bottom-up technological details into a top-down general equilibrium framework, we consider a stylized static closed economy. On the production side, firms minimize costs of producing output subject to nested constant-elasticity-of-substitution (CES) functions that describe the price-dependent use of factors and intermediate input. In the production of some macro good ROI, capital and electricity inputs trade off in the lower nest. The capital-electricity composite is then combined at the top-level with labor. The unit-profit function of macro-good production \((i \in ROI)\) reads as:

\[
\Pi^Y_i = p_i - \{\theta_{L,i} p_L^{1-\sigma} + (1 - \theta_{L,i})[\theta_{ELE,i} p_{ELE}^{1-\sigma_{ELE,i}} + (1 - \theta_{ELE,i}) p_K^{1-\sigma_{ELE,i}}]^{1/\sigma}\}^{1/\sigma}
\]

where:

- \(p_i\) is the price of good \(i\),
- \(p_L\) refers to the price of labor,
- \(p_{ELE}\) denotes the electricity price,
- \(p_K\) represents the price of capital,
- \(\theta_{L,i}\) is the cost share of labor in production of good \(i\),
- \(\theta_{ELE,i}\) represents the cost share of electricity in the sector-specific capital-electricity composite,
- \(\sigma\) is the elasticity of substitution between labor and non-labor inputs, and
- \(\sigma_{ELE,i}\) is the elasticity of substitution between electricity and capital.

In the production of fossil fuels – here: coal, gas, and oil – all inputs, except for the sector-specific fossil-fuel resource, are aggregated in fixed proportions at the lower nest. At the top level this aggregate trades off with the sector-specific fossil fuel resource at a constant elasticity of substitution.\(^7\) The unit-profit function for fossil fuel production \((i \in FF)\) is:

\[
\Pi^Y_i = p_i - \{\theta_{Q,i} p_{Q,i}^{1-\sigma_i} + (1 - \theta_{Q,i})[\theta_{ROI,i} p_{ROI} + (1 - \theta_{ROI,i}) p_L]^{1-\sigma_i}\}^{1/\sigma_i}
\]

where:

- \(p_{Q,i}\) represents the price of the fossil fuel resource \((i \in FF)\),
- \(p_{ROI}\) is the price of the ROI macro good,

\(^7\)The latter can then be calibrated in consistency with empirical estimates for price elasticities of fossil fuel supply.
$\theta_i$ denotes the cost share of the fossil fuel resource, 
$\theta_{ROI,i}$ refers the cost share of the ROI macro good in the aggregate input of ROI and labor, and 
$\sigma_i$ is the elasticity of substitution between the fossil fuel resource and the ROI-labor composite.

In our stylized example, we illustrate the integration of bottom-up activity analysis into the generic top-down representation of the overall economy along the example of the electricity sector. Rather than describing electricity generation by means of a single continuous smooth CES production function we capture production possibilities by discrete (Leontief-fix) technologies that are active or inactive in equilibrium depending on their profitability. The detailed technological representation may be necessary for an appropriate assessment of specific policy proposals. For example, energy policies may prescribe target shares of specific technologies in overall electricity production (such as green quotas) or the gradual elimination of certain power generation technologies (such as a nuclear phase-out). We can write the unit-profit functions of discrete power generation technologies as:

$$
\Pi_{ELE}^t = p_{ELE} - \theta_{ROI,t} p_{ROI} - \theta_{K,t} p_{K} - \sum_{i \in FF} \theta_{i,t} p_i - p_{U,t}
$$

where:
$p_{U,t}$ is the shadow price (rental rate) on the upper capacity bound for technology $t$,
$\theta_{ROI,t}$ denotes the cost share of ROI in electricity production by technology $t$,
$\theta_{K,t}$ refers to the cost share of capital in electricity production by technology $t$, and
$\theta_{i,t}$ represents the cost share of fossil fuel $i$ ($i \in FF$) in electricity production by technology $t$.

Finally, a composite consumption good is produced subject to a two-level CES technology where electricity and oil trade off at the second level and the electricity-oil composite is then combined with the macro good at the top level. The unit-profit function for the production of the final consumption good is:

$$
\Pi_C = p_C - \{\theta_{ROI,C} p_{ROI}^{1-\sigma_C} + (1 - \theta_{ROI,C})[\theta_{ELE,C} p_{ELE}^{1-\sigma_{ELE,C}} + (1 - \theta_{ELE,C}) p_{OIL}^{1-\sigma_{ELE,C}}] \}^{\frac{1}{1-\sigma_C}}
$$

where:
$p_C$ is the price of the final consumption composite,
$p_{OIL}$ denotes the price of oil,
$\theta_{ROI,C}$ represents the cost share of ROI in the final consumption aggregate,
\( \theta_{ELE,C} \) refers to the cost share of electricity in the oil-electricity composite of final consumption,

\( \sigma_C \) is the elasticity of substitution between energy and non-energy inputs in final consumption, and

\( \sigma_{ELE,C} \) denotes the elasticity of substitution between electricity and oil within the oil-electricity composite of final consumption.

In our stylized economy, a representative household is endowed with primary factors labor, capital, and fossil fuel resources (used for fossil fuel production). Total income of the household consists of factor payments:

\[
M = p_L \bar{L} + p_K \bar{K} + \sum_{i \in FF} p_{Q,i} \bar{Q}_i + \sum_t \bar{U}_t p_{U,t} \tag{15}
\]

where:

\( M \) is the income of the representative household,

\( \bar{L} \) denotes the aggregate labor endowment,

\( \bar{K} \) represents the aggregate capital endowment,

\( \bar{Q}_i \) refers to the resource endowment with fossil fuel (\( i \in FF \)), and

\( \bar{U}_t \) denotes the available capacity for technology \( t \).

The representative household maximizes utility from consumption subject to available income.

Flexible prices on competitive markets for factors and goods assure balance of supply and demand. Using Hotelling’s lemma, we can derive compensated supply and demand functions of goods and factors on the producer side. Composite consumption of the representative household is given by Roy’s identity.

Market clearance conditions for our stylized economy then read as:

- Labor market clearance:

\[
\bar{L} \geq \sum_i \frac{\partial \Pi^Y_i}{\partial p_L} Y_i + \sum_t \frac{\partial \Pi^{ELE}_t}{\partial p_L} X_t + \frac{\partial \Pi^C}{\partial p_L} C \tag{16}
\]

where:

\( Y_i \) denotes the level of production of good \( i \) (except for electricity),

\( C \) is the level of aggregate final consumption, and

\( X_t \) represents the level of electricity production by technology \( t \).

\[\text{Price rigidities such as fixed wages could be easily accommodated through the specification of explicit price constraints together with associated rationing conditions for the respective markets.}\]
• Capital market clearance:
\[ K \geq \sum_i \frac{\partial \Pi^Y}{\partial p_K} Y_i + \sum_t \frac{\partial \Pi^{ELE}}{\partial p_K} X_t \]  
(17)

• Market clearance for fossil fuel resources \((i \in FF)\):
\[ \dot{Q}_i \geq \frac{\partial \Pi^Y}{\partial p_{Q,i}} Y_i \]  
(18)

• Market clearance for capacity bounds:
\[ \ddot{U}_t \geq \frac{\partial \Pi^{ELE}}{\partial p_{U,t}} X_t \]  
(19)

• Market clearance for production goods (except for electricity):
\[ Y_i \geq \sum_j \frac{\partial \Pi^Y}{\partial p_i} Y_j + \sum_t \frac{\partial \Pi^{ELE}}{\partial p_i} X_t + \frac{\partial \Pi^C}{\partial p_i} C \]  
(20)

• Market clearance for electricity:
\[ \sum_t X_t \geq \sum_i \frac{\partial \Pi^{ELE}}{\partial p_{ELE}} Y_i + \frac{\partial \Pi^C}{\partial p_{ELE}} C \]  
(21)

• Market clearance for the final consumption composite:
\[ C \geq \frac{M}{p_C} \]  
(22)

Figure 1 provides a diagrammatic structure of our stylized economy using the notations of our algebraic exposition (for the sake of transparency, we do no consider the bottom-up representation of electricity generation here).

As to the parameterization of our simple numerical model, benchmark prices and quantities, together with exogenous elasticities, determine the free parameters of the functional forms that describe technologies and preferences. Table 1 describes our benchmark equilibrium in terms of a social accounting matrix (King [1985]).

<table>
<thead>
<tr>
<th>Key</th>
<th>ROI: rest of industry</th>
<th>COA: coal</th>
<th>GAS: gas</th>
<th>OIL: oil</th>
<th>ELE: electricity</th>
<th>RA: household</th>
</tr>
</thead>
<tbody>
<tr>
<td>( ROI )</td>
<td>200</td>
<td>-5</td>
<td>-5</td>
<td>-10</td>
<td>-180</td>
<td></td>
</tr>
<tr>
<td>( COA )</td>
<td>15</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>( GAS )</td>
<td>15</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>( OIL )</td>
<td>30</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>( ELE )</td>
<td>-10</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td>-80</td>
<td>-20</td>
<td>100</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labor</td>
<td>-110</td>
<td>-5</td>
<td>-5</td>
<td>-10</td>
<td>130</td>
<td></td>
</tr>
<tr>
<td>Rent</td>
<td>-5</td>
<td>-5</td>
<td>-10</td>
<td>20</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 1: Base Year Equilibrium
In general, data consistency of a social accounting matrix requires that the sums of entries across each of the rows and columns equal zero. Market equilibrium conditions are associated with the rows, the columns capture the zero-profit condition for production sectors as well as the income balance for the aggregate household sector. Benchmark data are typically delivered in value terms, i.e. they are products of prices and quantities. In order to obtain separate price and quantity observations, the common procedure is to choose units for goods and factors so that they have a price of unity (net of potential taxes or subsidies) in the benchmark equilibrium. Then, the value terms simply correspond to the physical quantities.

Table 2 provides a bottom-up description of initially active power technologies (here: gas-fired power plants, coal-fired power plants, nuclear power plants, and hydro power plants) for the base year. Note that the benchmark outputs of active technologies sum up to economy-wide electricity demand while input requirements add up to aggregate demands as reported in the social accounting matrix. Table 3 includes bottom-up technology coefficients (cost data) for initially inactive technologies (here: wind, solar, and biomass). In our example, unit-output of inactive technologies is listed as 10% more costly than the electricity price in the base year.$^9$

$^9$In our exposition, we impose consistency of aggregate top-down data with bottom-up technology data. In modelling practise, the harmonization of bottom-up data with top-down data may require substantial data adjustments to create a consistent database for the hybrid model.

$^{10}$The cost gap for inactive technologies is an input that can be easily adjusted according to user assumptions within our numerical model implementation (see Appendix).
We can formulate the integrated top-down and bottom-up model as a system of weak inequalities and complementarity conditions based on the MCP approach. Appendix A provides a compact summary of the algebraic equilibrium conditions for our stylized hybrid model. The model is implemented in GAMS (Brooke et al. [1996]) using PATH (Dirkse and Ferris [1995]) as a solver. The programming files are attached in Appendix B – formulated either as an explicit MCP based on plain algebra or as an implicit MCP based on the meta-language MPSGE (Rutherford [1999a]).

## 4 Policy Simulations

In this section, we illustrate the use of our stylized hybrid bottom-up/top-down model for the economic assessment of three energy policy initiatives that figure prominently at the EU level: (i) nuclear phase-out, (ii) target quotas for renewables in electricity production (green quotas), and (iii) carbon taxation.

A central issue surrounding the controversial policy debate of these initiatives is the induced economic adjustment effects. Model-based simulation results of these effects may not only differ in the order of magnitude but even in the sign depending on the underlying parameterization and behavioral assumption. A concrete bottom-up representation of technological options may improve the "credibility" of model results. Furthermore, the MCP formulation of the hybrid bottom-up/top-down model permits representation of potentially important second-best effects that are typically omitted from market equilibrium models phrased as optimization problems.

In order to test the robustness of model results, sensitivity analysis with respect to uncertainties in the model’s parameterization space is inevitable. A deliberate sensitivity analysis helps to identify robust insights on the complex relationships between assumptions (inputs) and results (outputs), i.e., to sort out the relative importance of a priori uncertainties. In this vein, our stylized model framework allows for user-defined changes of key model parameters.\(^{11}\) Our results section below is restrained to the central case parameterization.

\(^{11}\)The interested reader can use the GAMS program in the Appendix to perform sensitivity analysis.
and reports on selected economic dimensions such as welfare impacts (measured as Hicksian equivalent variation in income) or the composition of energy supply by technologies.

4.1 Nuclear Phase-Out

Reservations against the use of nuclear power are reflected in policy initiatives of several EU Member States (Belgium, Germany, the Netherlands, Spain, and Sweden) that foresee a gradual phase-out of their nuclear power programs (OECD/IEA [2001]). In our stylized hybrid model, policy constraints on the use of nuclear power can be easily implemented via parametric changes of upper bounds (here: $\bar{U}_{\text{nuclear}}$).

Figure 2 reports the welfare changes (vis-à-vis the benchmark level) as a function of the continuous reduction in nuclear power use. We report adjustment costs for two alternative assumptions on the relevant time horizon which are accommodated as a simple user-defined parametric switch in our model program: In the short-run analysis – labeled as “short” – we assume that capital embodied in extant technologies is not malleable, whereas the long-run analysis – labeled as “long” – presumes fully malleable (mobile) capital across all sectors and technologies. Obviously, adjustment costs to binding technological constraints are substantially higher in the short-run with restricted capital malleability (“stranded investment”).

![Figure 2: Welfare Changes for Nuclear Phase-Out](image)

Figure 3 illustrates the changes in the supply of electricity across the different technologies in the long-run. For our illustrative cost parameterization of technologies, the administered decrease in nuclear power generation will be replaced by an increase in gas- and coal-based power generation whereas renewable technologies remain slack activities (apart from hydro...
which is already operated at the upper bound in the reference situation).

![Figure 3: Technology Shifts in Power Production for Nuclear Phase-Out](image)

4.2 Renewables Targets (Green Quotas)

Renewable energy technologies have received political support within the EU since the early 1970ies. After the oil crises renewable energy was primarily seen as a long-term substitution to fossil fuels in order to increase EU-wide security of supply. In the light of climate change, the motive has shifted to environmental concerns: Renewables are considered as an important alternative to thermal produced electricity that emits greenhouse gases. In 2001, the EU Commission issued a Directive which aims at doubling the share of renewable energy in EU-wide gross energy consumption 2010 as compared to 1997 levels (European Commission (EC) [2001]). In our stylized framework, we can implement the prescription of green quotas by setting a cumulative quantity constraint on the share of electricity that comes from renewable energy sources. This quantity constraint is associated with a complementary endogenous subsidy on renewable electricity production (paid by the representative household). The required changes to the algebraic model formulation include (i) the explicit quantity constraint on the target quota, (ii) endogenous subsidies on green electricity production, and (iii) the adjustment of the income constraint to account for overall subsidy payments (see Appendix). In our base year, the share of electricity produced by renewable energy sources (here: hydro) amounts to roughly 13%. In the counterfactual, we gradually increase this share to 33%. Figures 4 and 5 report the short-run and long-run implications for economic welfare and required subsidy rates.
4.3 Carbon Taxation (Environmental Tax Reform)

Over the last decade, several EU Member States have levied some type of carbon tax in order to reduce greenhouse gas emissions from fossil fuel combustion that contribute to anthropogenic global warming (OECD [2001]). In this context, the debate on the double dividend
hypothesis has addressed the question of whether the usual trade-off between environmental benefits and gross economic costs\textsuperscript{12} of emission taxes prevails in economies where distortionary taxes finance public spending. Emission taxes raise public revenues which can be used to reduce existing tax distortions. Revenue recycling may then provide prospects for a double from emission taxation (Goulder [1995]): Apart form an improvement in environmental quality (the first dividend), the overall excess burden of the tax system may be reduced by using additional tax revenues for a revenue-neutral cut of existing distortionary taxes (the second dividend).\textsuperscript{13}

Since our stylized hybrid model in MCP format is not limited by integrability constraints, we can use it to investigate the rationale behind the double dividend discussion. As a first step, we must refine Table 1 which so far only reports base year economic flows on a gross of tax basis in order to reflect some public finance information on initial taxes and public consumption. For the sake of simplicity, we assume that public demand amounts to some fixed share of base year ROI final consumption. The public consumption is financed by a distortionary consumption tax on ROI. In our policy simulations, we investigate the economic effects of carbon taxes that are set sufficiently high to reduce carbon emissions by 5\%, 10\%, 15\%, and 20\% compared to the base year emission level. While keeping the level of public good consumption at the base-year level, the additional carbon tax revenues can be either recycled lump-sum to the representative household or can be used to cut back distortionary capital taxes.

![Figure 6: Welfare Changes for Alternative Environmental Tax Reforms](image)

\textsuperscript{12}That is the costs disregarding environmental benefits.

\textsuperscript{13}If – at the margin – the excess burden of the environmental tax is smaller than that of the replaced (decreased) existing tax, public financing becomes more efficient and welfare gains will occur.
Figure 6 depicts the welfare implications of our environmental tax reforms. The first insight – in line with the undisputed weak-double dividend hypothesis (see Goulder 1995) – is that the reduction of the distortionary consumption tax is superior in efficiency terms as compared to a pure lump-sum recycling of carbon tax revenues. For modest environmental targets, we might even obtain a strong double-dividend from revenue-neutral cuts in the distortionary consumption tax. The second insight is less obvious and involves a bit more tricky second-best analysis: Even lump-sum recycling of carbon taxes may provide a strong double dividend when carbon reduction targets are set sufficiently low. The reasoning behind is that the initial consumption tax is only partially levied on non-energy consumption which distorts consumer choices in favor of energy (here: electricity) consumption. The imposition of carbon taxes counteracts to some level the initial distortions by the partial consumption tax as they lead to a relative price increase of primarily fossil-fuel based electricity.

5 Conclusions

There is a commonly perceived dichotomy between top-down CGE models and bottom-up energy system models dealing with energy issues. Bottom-up models provide a detailed description of the energy system from primary energy processing via multiple conversion, transport, and distribution processes to final energy use but neglect interactions with the rest of the economy. Furthermore, the formulation of such models as mathematical programs restricts their direct applicability to integrable equilibrium problems; many interesting policy problems involving initial inefficiencies can therefore not be handled – except for reverting to rather non-transparent sequential joint maximization techniques (Rutherford [1999b]). CGE models on the other hand are able to capture market interactions and inefficiencies in a comprehensive manner but typically lack technological details that might be relevant for the policy issue at hand.

In this paper, we have motivated the MCP approach to bridge the gap between bottom-up and top-down analysis. Through the explicit representation of weak inequalities and complementarity between decision variables and functional relationships, the MCP approach allows to exploit the advantages of each model type – technological details of bottom-up models and economic richness of top-down models – in a single mathematical format.

Despite the coherence and logical appeal of the integrated MCP approach, dimensionality may impose limitations on its practical application. Bottom-up programming models of the energy system often involve a large number of bounds on decision variables. These bounds are treated implicitly in the mathematical programming approach but introduce unavoidable complexity in the integrated complementarity formulation as they must be associated with explicit price variables in order to account for income effects. Therefore, future research may be dedicated to decomposition approaches that permit consistent combination of complex top-down models and large-scale bottom-up energy system models for energy policy analysis.
References


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Appendix A: Algebraic Model Formulation

We can formulate the integrated top-down and bottom-up model as a system of weak inequalities and complementarity conditions based on the MCP approach. Table A1 provides the algebraic equilibrium conditions for our stylized hybrid model. The notations for variables and parameters employed within the algebraic exposition are explained in Tables A2 and A3.\textsuperscript{14}

Table A1: Equilibrium Conditions

<table>
<thead>
<tr>
<th>Zero profit conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>( \Pi_Y^i = p_i - [(\theta_{L,i}p_L)^{1-\sigma_i} + (1 - \theta_{L,i})\theta_{ELE,i}p_{ELE,i}]^{1-\sigma_{ELE,i}} ) ( \downarrow Y_i )</td>
</tr>
<tr>
<td>( \Pi_Y^i = p_i - [\theta_{i}p_i^{1-\sigma_i} + (1 - \theta_{i})\theta_{ROI,i}p_{ROI} + (1 - \theta_{ROI,i})p_L]^{1-\sigma_i} ) ( \downarrow Y_i )</td>
</tr>
<tr>
<td>( \Pi_C = p_C - \theta_{ROI,C}p_{ROI} - \theta_{K,t}p_K - \sum_{(i\in FF)}\theta_{FF,i}p_{FF} - p_{U,t} ) ( \downarrow C )</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Market clearance conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>( \bar{L} \geq \sum_i \frac{\partial \Pi_Y^i}{\partial p_L} Y_i + \sum_t \frac{\partial \Pi_{ELE,t}^i}{\partial p_L} X_t ) ( \downarrow p_L )</td>
</tr>
<tr>
<td>( \bar{K} \geq \sum_i \frac{\partial \Pi_Y^i}{\partial p_K} Y_i + \sum_t \frac{\partial \Pi_{ELE,t}^i}{\partial p_K} X_t ) ( \downarrow p_K )</td>
</tr>
<tr>
<td>( \bar{Q}<em>i \geq \frac{\partial \Pi_Y^i}{\partial p</em>{Q,i}} Y_i ) ( \downarrow p_{Q,i} )</td>
</tr>
<tr>
<td>( \bar{U}<em>t \geq \frac{\partial \Pi</em>{ELE,t}}{\partial p_{U,t}} X_t ) ( \downarrow p_{U,t} )</td>
</tr>
</tbody>
</table>

\textsuperscript{14}We use the "\( \perp \)" operator to indicate complementarity between equilibrium conditions and the respective decision variables.
\[ Y_i \geq \sum_j \frac{\partial n^{Y_j}}{\partial p_i} Y_j + \sum_t \frac{\partial n^{ELE}_t}{\partial p_i} X_t + \frac{\partial n^C}{\partial p_i} C \] \quad \downarrow p_i

- Electricity:
\[ \sum_t X_t \geq \sum_i \frac{\partial n^{Y_i}}{\partial p_{ELE}} Y_i + \frac{\partial n^C}{\partial p_{ELE}} C \] \quad \downarrow p_{ELE}

- Final consumption composite:
\[ C \geq \frac{M}{\tilde{p}_C} \] \quad \downarrow p_C

\begin{center}
\textit{Income balance}
\end{center}

\[ M = p_L \bar{L} + p_K \bar{K} + \sum_{i \in FF} p_{Q,i} \bar{Q}_i + \sum_t \bar{U}_{t,pu,t} \] \quad \downarrow M

<table>
<thead>
<tr>
<th>Table A2: Variables</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Activity variables</strong></td>
</tr>
<tr>
<td>( Y_i )</td>
</tr>
<tr>
<td>( C )</td>
</tr>
<tr>
<td>( X_t )</td>
</tr>
<tr>
<td><strong>Price variables</strong></td>
</tr>
<tr>
<td>( p_i )</td>
</tr>
<tr>
<td>( p_L )</td>
</tr>
<tr>
<td>( p_K )</td>
</tr>
<tr>
<td>( p_{U,t} )</td>
</tr>
<tr>
<td>( p_{Q,i} )</td>
</tr>
<tr>
<td>( p_C )</td>
</tr>
<tr>
<td><strong>Income variables</strong></td>
</tr>
<tr>
<td>( M )</td>
</tr>
</tbody>
</table>
### Table A3: Cost Shares, Elasticities, and Endowments

<table>
<thead>
<tr>
<th>Cost shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\theta_{L,i}$</td>
</tr>
<tr>
<td>$\theta_{ELE,i}$</td>
</tr>
<tr>
<td>$\theta_i$</td>
</tr>
<tr>
<td>$\theta_{ROI,i}$</td>
</tr>
<tr>
<td>$\theta_{ROI,C}$</td>
</tr>
<tr>
<td>$\theta_{ELE,C}$</td>
</tr>
<tr>
<td>$\theta_{ROI,t}$</td>
</tr>
<tr>
<td>$\theta_{K,t}$</td>
</tr>
<tr>
<td>$\theta_{FF,t}$</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Elasticities of substitution</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\sigma$</td>
</tr>
<tr>
<td>$\sigma_{ELE,i}$</td>
</tr>
<tr>
<td>$\sigma_i$</td>
</tr>
<tr>
<td>$\sigma_C$</td>
</tr>
<tr>
<td>$\sigma_{ELE,C}$</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Endowments</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\bar{L}$</td>
</tr>
<tr>
<td>$\bar{K}$</td>
</tr>
<tr>
<td>$\bar{Q}_{FF}$</td>
</tr>
<tr>
<td>$\bar{U}_t$</td>
</tr>
</tbody>
</table>
Appendix B: GAMS Programs

5.1 MCP Formulation

$Title Static maquette of integrated TD/BU hybrid model

Model formulation in MCP

===========================================================================

Model code for stylized integrated bottom-up/top-down analysis of energy policies based on:

ZEW Discussion Paper 05-28
Integrating Bottom-Up into Top-Down:
A Mixed Complementarity Approach

Contact the authors at: boehringer@zew.de; rutherford@colorado.edu

============================================================================

For plotting the results you must have installed the gnuplot-shareware (see http://debreu.colorado.edu/gnuplot/gnuplot.htm for downloads)

============================================================================

List of parameters subject to sensitivity analysis
The user can change the default settings.

Choice of key elasticities:
$if not setglobal esub_c $setglobal esub_c 0.5
Elasticity of substitution in final consumption

$if not setglobal esub_gas $setglobal esub_gas 1.5
Elasticity in gas supply

$if not setglobal esub_coal $setglobal esub_coal 3
Elasticity in coal supply

$if not setglobal esub_oil $setglobal esub_oil 1.5
Elasticity in oil supply

Choice of resource availability for renewables:
(as a fraction of base-year total electricity production)

Potential wind supply - (%)
if not setglobal p_wind $setglobal p_wind 10

* Potential solar supply - (%)
if not setglobal p_sun $setglobal p_sun 10

* Potential biomass supply - (%)
if not setglobal p_trees $setglobal p_trees 10

* Cost disadvantage of initial slack technologies:

* Wind energy premium (%)
if not setglobal c_wind $setglobal c_wind 10

* Solar energy premium (%)
if not setglobal c_solar $setglobal c_solar 10

* Biomass energy premium (%)
if not setglobal c_biomass $setglobal c_biomass 10

* Other central model assumptions:

* Time horizon (short, long)
if not setglobal horizon $setglobal horizon long

*============================================================================

* Assign user-specific changes of default assumptions
scalar shortrun Flag for short-run capital mobility/1/;

if "%horizon%"="long" shortrun=0;

* Elasticitities of substitution (ESUB)
scalar esub_c Elasticity of substituion in final demand /%esub_c%/ esub_ele ESUB between electricity and oil in final demand /0.5/ esub_k_e ESUB between capital and energy in ROI production /0.5/ esub_l_ke ESUB between labor and other inputs in ROI production /0.8/;

set t Electricity Technologies (current and future) /coal,gas,nuclear,hydro,wind,solar,biomass/;

set xt(t) Existing technologies /coal,gas,nuclear,hydro/;
set nt(t) New vintage technologies /wind,solar,biomass/;
set ff Fossil fuel inputs /coa, gas, oil/;
set n Natural resources /wind, sun, trees/;
set res(t) Renewable energy sources /hydro, wind, solar, biomass/;

* The following data table describes an economic equilibrium in
* the base year:

<table>
<thead>
<tr>
<th>Table: sam Base year social accounting matrix</th>
</tr>
</thead>
<tbody>
<tr>
<td>roi  coa gas oil ele ra</td>
</tr>
<tr>
<td>roi 200 -5 -5 -10 -10 -170</td>
</tr>
<tr>
<td>coa 15</td>
</tr>
<tr>
<td>gas 15</td>
</tr>
<tr>
<td>oil 30 -30</td>
</tr>
<tr>
<td>ele -10</td>
</tr>
<tr>
<td>capital -80</td>
</tr>
<tr>
<td>labor -110</td>
</tr>
<tr>
<td>rent -5 -5 -10</td>
</tr>
<tr>
<td>labor -110 -5 -5 -10 130</td>
</tr>
<tr>
<td>capital -80 -20 100</td>
</tr>
<tr>
<td>rent -5 -5 -10 20</td>
</tr>
<tr>
<td>labor -110 -5 -5 -10 130</td>
</tr>
<tr>
<td>capital -80 -20 100</td>
</tr>
<tr>
<td>rent -5 -5 -10 20</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Parameter: carbon(ff) Carbon coefficients /oil 1, gas 1, coa 2/;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parameter: esub_ff(ff) Elasticity of substitution in fossil fuel production</td>
</tr>
<tr>
<td>/gas esub_gas%, coa esub_coal%, oil esub_oil%;</td>
</tr>
</tbody>
</table>

* The following data tables describes electricity generation in
* the base year as well as the technology coefficients for technologies
* which are inactive in the base year (wind, solar, biomass). Inactive
* technologies are by defaults %c_****% more costly.

<table>
<thead>
<tr>
<th>Table: xtelec Electricity technologies - extant (initially active)</th>
</tr>
</thead>
<tbody>
<tr>
<td>coal gas nuclear hydro ele 20 20 12 8</td>
</tr>
<tr>
<td>roi -1 -1 -8</td>
</tr>
</tbody>
</table>
gas -15
coa -15
capital -4 -4 -4 -8;

table ntelec  Electricity technologies - new vintage (initially inactive)

<table>
<thead>
<tr>
<th></th>
<th>wind</th>
<th>solar</th>
<th>biomass</th>
</tr>
</thead>
<tbody>
<tr>
<td>ele</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>roi</td>
<td>-.2</td>
<td>-.3</td>
<td>-.4</td>
</tr>
<tr>
<td>capital</td>
<td>-.9</td>
<td>-.8</td>
<td>-.7</td>
</tr>
<tr>
<td>wind</td>
<td>-1.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>sun</td>
<td></td>
<td>-1.0</td>
<td></td>
</tr>
<tr>
<td>trees</td>
<td></td>
<td></td>
<td>-1.0</td>
</tr>
</tbody>
</table>

* Adjust the cost coefficients for initially inactive technologies according to user assumptions:

set xk /roi, capital/;

ntelec(xk,"wind") = ntelec(xk,"wind") * (100+%c_wind%)/110;
ntelec(xk,"solar") = ntelec(xk,"solar") * (100+%c_solar%)/110;
ntelec(xk,"biomass") = ntelec(xk,"biomass") * (100+%c_biomass%)/110;

* Specify limits (resource or policy constraints) to the availability of technologies

parameter limit  Electricity supply limits on extant technologies /
  nuclear  12
  hydro    8 /;

parameter nrsupply(n)  Natural resource supplies (fraction of base output)/
  wind     %p_wind%
  sun      %p_sun%
  trees    %p_trees%

nrsupply(n) = nrsupply(n)/100 * sam("ele","ele");

parameter c0  Baseyear final consumption;
c0 = (-sam("roi","ra")-sam("ele","ra")-sam("oil","ra"));
set quota(t) Flag for technologies contributing to green quota;

quota(t) = no;

scalar share Target share for green quota /0/;

* By default we might set target share for green quota at base year level

share = sum(t$res(t), xtelec("ele",t))/sum(t, xtelec("ele",t));

display share;

scalar

dd Flag for double dividend policy analysis /0/,
ls Flag for lump-sum revenue-recycling /0/,
vat Flag for VAT revenue recycling /0/,
g0 Base year public consumption /0/,
tc0 Base year consumption tax /0/;

positive variables

* Activitiy levels
roi Aggregate output
tele(t) Production levels for electricity by technology
s(ff) Fossil fuel supplies
c Aggregate consumption (utility) formation
g Public good provision

* Price levels
proi Price of aggregate output
pele Price of electricity
pf(ff) Price of oil and gas
pl Wage rate
pk Price of malleable capital for X (and NT elec)
pr(ff) Rent on fossil fuel resources
pn(n) Rent on natural resources
pc Consumption (utility) price index
pg Price of public consumption
plim(t) Shadow price on electricity expansion
pNx(t) Price of capital to extant technologies
pcarb Carbon tax rate

* Income variables
ra Representative household
govt Government
Endogenous taxes or subsidies

\[ \tau \] Uniform subsidy rate on renewable energy;

Positive variables

\[ \phi_{ls} \] Lump-sum recycling
\[ \phi_{tc} \] Consumption tax recycling;

Equations

Zero profit conditions for activities linked to activity levels

\[ zprf_{roi} \] Zero profit condition for macro production sector
\[ zprf_{ele}(t) \] Zero profit condition for alternative electricity supply technologies
\[ zprf_{s}(ff) \] Zero profit condition for fossil fuel supplies
\[ zprf_{c} \] Zero profit condition for aggregate utility formation
\[ zprf_{g} \] Zero profit condition for public good formation

Market clearance conditions for goods linked to prices

\[ mkt\_proi \] Market clearance condition for macro production good
\[ mkt\_ele \] Market clearance condition for electricity
\[ mkt\_pf(ff) \] Market clearance condition for fossil fuels coal and gas
\[ mkt\_pl \] Market clearance condition for labor
\[ mkt\_pk \] Market clearance condition for malleable capital
\[ mkt\_pr(ff) \] Market clearance conditions for fossil fuel resources
\[ mkt\_pn(n) \] Market clearance conditions for natural resources
\[ mkt\_pcarb \] Market clearance condition for carbon
\[ mkt\_pkx(t) \] Market clearance condition for capital inputs to extant power production
\[ mkt\_plim(t) \] Market clearance condition for capacity on electricity expansion
\[ mkt\_pc \] Market clearance for aggregate utility good
\[ mkt\_g \] Market clearance for public good

Income balance for representative household linked to income level

\[ inc\_ra \] Budget constraint for representative household
\[ inc\_govt \] Budget constraint for government

Additional constraints

\[ sub\_res \] Endogenous subsidy to achieve renewable energy quota
\[ eqy_{ls} \] Equal yield constraint for lump-sum recycling
\[ eqy_{tc} \] Equal yield constraint for consumption tax recycling

Parameter

\[ \theta_{l\_roi} \] Cost share of labor in ROI production
\[ \theta_{ele\_roi} \] Cost share of electricity in capital-electricity composite of ROI
\( \theta_r_{ff}(ff) \) Cost share of fossil fuel resource in fossil fuel production
\( \theta_l_{ff}(ff) \) Cost share of labor in non-resource input of fossil fuel production
\( \theta_{roi}_{ff}(ff) \) Cost share of ROI in ROI-labor composite of fossil fuel production
\( \theta_{ele}_{c} \) Cost share of electricity in oil-electricity composite of final consumption
\( \theta_{roi}_{c} \) Cost share of ROI in final consumption
\( \theta_{roi}_{t}(t) \) Cost share of ROI in electricity production by technology \( t \)
\( \theta_{k}_{t}(t) \) Cost share of capital in electricity production by technology \( t \)
\( \theta_{ff}_{t}(ff,t) \) Cost share of fossil fuel in electricity production by technology \( t \);

\[
\theta_{roi}_{c} = \frac{-\text{sam}("roi","ra")}{c0};
\]
\[
\theta_{l}_{roi} = \frac{-\text{sam}("labor","roi")}{\text{sam}("roi","roi")};
\]
\[
\theta_{ele}_{roi} = \frac{-\text{sam}("ele","roi")}{\text{sam}("roi","roi")};
\]
\[
\theta_{r}_{ff}(ff) = \frac{-\text{sam}("rent","ff")}{\text{sam}("rent","ff") + \text{sam}("roi","ff") + \text{sam}("labor","ff")};
\]
\[
\theta_{roi}_{ff}(ff) = \frac{-\text{sam}("roi","ff")}{\text{sam}("roi","ff") + \text{sam}("labor","ff")};
\]
\[
\theta_{ele}_{c} = \frac{-\text{sam}("ele","ra")}{\text{sam}("ele","ra") + \text{sam}("oil","ra")};
\]
\[
\theta_{roi}_{t}(t) = \frac{-\text{xtelec}("roi","t")}{\text{xtelec}("ele","t")};
\]
\[
\theta_{k}_{t}(t) = \frac{-\text{xtelec}("capital","t")}{\text{xtelec}("ele","t")};
\]
\[
\theta_{ff}_{t}(ff,t) = \frac{-\text{xtelec}(ff,t)}{\text{xtelec}("ele","t")};
\]
\[
\theta_{roi}_{t}(t) = \frac{-\text{ntelec}("roi","t")}{\text{ntelec}("ele","t")};
\]
\[
\theta_{k}_{t}(t) = \frac{-\text{ntelec}("capital","t")}{\text{ntelec}("ele","t")};
\]
\[
\theta_{l}_{ff}(ff) = \frac{-\text{sam}("labor","ff")}{\text{sam}("labor","ff") + \text{sam}("roi","ff")};
\]

* Definition of zero profit conditions

\[
\text{zprf}_roi..\]
\[
(\theta_l_{roi} \cdot pl^{(1-esub_{l_{ke}})} + (1- \theta_l_{roi}) \cdot \text{proi}) \cdot \text{xst}(t) = \text{proi};
\]
\[
\text{zprf}_ele(t) ..
\]
\[
(\theta_{roi}_{t}(t) \cdot \text{proi} + \text{sum}(ff, \theta_{ff}_{t}(ff,t) \cdot pff)) \cdot \text{xst}(t) + (\theta_{k}_{t}(t) \cdot pkx(t)) \cdot \text{shortrun} + (\theta_{k}_{t}(t) \cdot pk) \cdot \text{not shortrun} + \text{plim}(t) \cdot \text{limit}(t) = \text{pele} \cdot (1 + \text{tau} \cdot \text{quota}(t));
\]
\[
\text{zprf}_s(ff) ..
\]
\[
(\theta_{r}_{ff}(ff) \cdot pr(ff) \cdot (1-esub_{ff}(ff)) + (1-\theta_{r}_{ff}(ff)) \cdot \text{pl} + (1-\theta_{l}_{ff}(ff)) \cdot \text{proi} \cdot (1-esub_{ff}(ff)) \cdot (1/(1-esub_{ff}(ff))) + (\text{carbon}(ff) \cdot pcarb) \cdot \text{carblim} = 0;
\]

28
* Definition of market clearance conditions

### mkt_proi

\[
\text{roi} \times \text{sam}("roi","roi") = G =
\sum(x_t, \text{ele}(x_t) \times (-\text{xtelec}("roi",x_t)/\text{xtelec}("ele",x_t)))
+ \sum(n_t, \text{ele}(n_t) \times (-\text{xtelec}("roi",n_t)))
+ \sum(f_f, (-\text{sam}("roi","ff") \times \text{s}(ff) \times ((\text{theta}_r \times \text{pf}(ff) \times (1-\text{esub}_f))))
+ (1-\text{theta}_r \times \text{pf}(ff)) \times ((\text{theta}_l \times \text{pl}))
+ (1-\text{theta}_l \times \text{pl}) \times \text{proi} \times (1/(1-\text{esub}_f)))
\]

### mkt_pele

\[
\sum(t, \text{ele}(t)) = G =
(-\text{sam}("ele","ra")) \times c \times (\text{pc}/(\text{theta}_e \times \text{pele} \times (1-\text{esub}_e)))
+ (1-\text{theta}_e \times \text{pf}(\text{oil}) \times (1-\text{esub}_e))((1/(1-\text{esub}_e))) \times \text{esub}_c

### mkt_pf(ff)

\[
\text{sam}(ff,ff) \times \text{s}(ff) = G =
\sum(x_t, (-\text{xtelec}(ff,x_t)/\text{xtelec}("ele",x_t)) \times \text{ele}(x_t)))
+ (-\text{sam}(ff,"ra")) \times c \times (\text{pc}/(\text{theta}_e \times \text{pele} \times (1-\text{esub}_e)))
+ (1-\text{theta}_e \times \text{pf}(\text{oil}) \times (1-\text{esub}_e))((1/(1-\text{esub}_e))) \times \text{esub}_c

### mkt_pl

\[
\text{sam}(ff,ff) \times \text{s}(ff) = G =
\sum(x_t, (-\text{xtelec}(ff,x_t)/\text{xtelec}("ele",x_t)) \times \text{ele}(x_t)))
+ (-\text{sam}(ff,"ra")) \times c \times (\text{pc}/(\text{theta}_e \times \text{pele} \times (1-\text{esub}_e)))
+ (1-\text{theta}_e \times \text{pf}(\text{oil}) \times (1-\text{esub}_e))((1/(1-\text{esub}_e))) \times \text{esub}_c
\]
\[ \text{sam("labor","ra") =G=} \]
\[ (-\text{sam("labor","roi")}*\text{roi}(\text{proi}/\text{pl})*\text{esub}_l_{ke} \]
\[ + \text{sum(ff, (-}\text{sam("labor",ff)})*s(ff))*((\text{theta}_r_{ff}(ff)\text{pr}(ff)*(1-}\text{esub}_ff(ff)) \]
\[ + (1-\text{theta}_l_{ff}(ff))*p_{pl} \]
\[ + (1-\text{theta}_l_{ff}(ff))*\text{proi}*(1-}\text{esub}_ff(ff))**(1/(1-}\text{esub}_ff(ff))) \]
\[ / ((\text{theta}_l_{ff}(ff)*p_{pl} + (1-\text{theta}_l_{ff}(ff))*\text{proi})*\text{esub}_ff(ff)); \]

\[ \text{mk}_t_{pk}.\]
\[ (-\text{sam("capital","roi")}+\text{sum(xt,(-xtelec("capital",xt))))}(\text{not shortrun}) =G= \]
\[ (-\text{sam("capital","roi")})*\text{proi}/((\text{theta}_ele_{roi}\text{pele}^{(1-}\text{esub}_k_{e}) \]
\[ + (1-\text{theta}_ele_{roi})*\text{pk}^{(1-}\text{esub}_k_{e})**(1/(1-}\text{esub}_k_{e})))**\text{esub}_l_{ke} \]
\[ *((\text{theta}_ele_{roi}\text{pele}^{(1-}\text{esub}_k_{e}) \]
\[ + (1-\text{theta}_ele_{roi})*\text{pk}^{(1-}\text{esub}_k_{e})**(1/(1-}\text{esub}_k_{e}))/\text{pk}**\text{esub}_k_{e} \]
\[ + \text{sum(xt}(\text{not shortrun}),(-xtelec("capital",xt)/xtelec("ele",xt))*\text{ele}(xt)) \]
\[ + \text{sum(nt,(-ntelec("capital",nt))}\text{ele}(nt)); \]

\[ \text{mk}_t_{pr}(ff).\]
\[ (-\text{sam("rent","ff")} =G= \]
\[ (-\text{sam("rent","ff")})*s(ff))*((\text{theta}_r_{ff}(ff)\text{pr}(ff)*(1-}\text{esub}_ff(ff)) \]
\[ + (1-\text{theta}_l_{ff}(ff))*p_{pl} \]
\[ + (1-\text{theta}_l_{ff}(ff))*\text{proi}**(1-}\text{esub}_ff(ff))**(1/(1-}\text{esub}_ff(ff)))/\text{pr}(ff)** \text{esub}_ff(ff); \]

\[ \text{mk}_t_{pn}(n).\]
\[ \text{nrsupply}(n) =G= \text{sum(nt,(-ntelec(n,nt))}\text{ele}(nt)); \]

\[ \text{mk}_t_{pk}(xt)\text{shortrun}.\]
\[ (-\text{xtelec("capital",xt)}) =G= (-\text{xtelec("capital",xt)}/\text{xtelec("ele",xt)})*\text{ele}(xt); \]

\[ \text{mk}_t_{plim}(xt)\text{limit}(xt).\]
\[ \text{limit}(xt) =G= \text{ele}(xt); \]

\[ \text{mk}_t_{pcarb}\text{carblim}.\]
\[ \text{carblim} =G= \text{sum(ff,carbon}(ff)\text{sam(ff,ff)})*s(ff)); \]

\[ \text{mk}_t_{pc} .. \]
\[ \text{c0}*c =G= \text{ra}/\text{pc} ; \]

\[ \text{mk}_t_{g\&dd} .. \]
\[ \text{g0}*g =G= \text{govt}/\text{pg} ; \]

* Income definition for representative household

\[ \text{inc}_{ra}.\]
\[ (-\text{sam("capital","roi")}+\text{sum(xt,(-xtelec("capital",xt))))}(\text{not shortrun})*\text{pk} \]

30
+ sum(xt$shortrun, (-xtelec("capital",xt))*pkx(xt))
+ sum(ff, (-sam("rent",ff))*pr(ff))
+ sum(n, nrsupply(n)*pn(n))
+ (carblim*pcarb)$carblim$(not dd)
- sum(t$quota(t), pele*ele(t)*tau)
- (pc*phi_ls)$dd
=G= ra;

* Income definition for government
inc_govt$dd..
(carblim*pcarb)$carblim + pc*phi_ls
+ (((-sam("roi","ra")(1+tc0$d)))*c
*( (pc/(proi*(1+(tc0*phi_tc)$dd)))*(1+tc0$d)**esub_c)*proi*tc0*phi_tc
=G= govt;

* Endogenous subsidy to assure renewables quota
sub_res$card(quota).. 
sum(t$res(t), ele(t)) =G= share*sum(t, ele(t));

* Endogenous equal yield constraints
eqy_ls$d.. 
g =G= 1;
eqy_tc$d.. 
g =G= 1;

* Define MCP model
model mcp_hybrid / zprf_roi.roi, zprf_ele.ele, zprf_s.s, zprf_c.c, zprf_g.g,
mkt_proi.proi, mkt_pele.pele, mkt_pf.pf, mkt_pl.pl,
mkt_pk.pk, mkt_pr.pr, mkt_pn.pn, mkt_pcarb.pcarb,
mkt_pkx.pkx, mkt_plim.plim, mkt_pc.pc, mkt_g.pg, inc_ra.ra,
sub_res.tau, inc_govt.govt, eqy_ls.phi_ls, eqy_tc.phi_tc
/

* Benchmark initialization

* In the base year new-vintage technologies are inactive
* and the prices of backstop natural resources are zero
* Extant technologies with capacity limits are assumed to
* operate at the upper bound with a zero shadow value in the
* base year

```
427  ele.l(nt) = 0;
428  pn.l(n)  = 0;
429  plim.l(xt) = 0;
430  ele.l(xt) = xtelec("ele",xt);
431
432  * Initialize activities and prices
433  roi.l = 1; ele.l(xt) = xtelec("ele",xt);  sl.l(ff) = 1; c.l = 1;
434  pri.l = 1; pele.l = 1; pf.l(ff) = 1; pl.l = 1; pk.l = 1; pr.l(ff) = 1;
435  pkx.l(t)$((-xtelec("capital",t))$shortrun) = 1; plim.l(t) = 0;
436  pn.l(n) = 1; pc.l = 1;
437
438  * Install lower bounds on prices to avoid division by zero in MCP formulation
439  proi.lo = 1e-5; pele.lo = 1e-5; pf.lo(ff) = 1e-5; pl.lo = 1e-5; pk.lo = 1e-5;
440  pr.lo(ff) = 1e-5; pkx.lo(t)$((-xtelec("capital",t))$shortrun) = 1e-5; pc.lo = 1e-5;
441
442  * Tie down "active" model specification
443  phi_tc.fx = 1; phi_ls.fx = 0;
444  g.fx = 0; pg.fx = 0; govt.fx = 0; pcarb.fx = 0;
445  pkx.fx(t)$((not (-xtelec("capital",t))$shortrun) = 0;
446  tau.fx$(not card(quota)) = 0;
447  plim.fx(t)$((not limit(t)) = 0;
448
449  * In the base year we have no new-vintage electricity and the prices of backstop natural resources are zero:
450
451  ele.l(nt) = 0;
452  pn.l(n)  = 0;
453  pcarb.l = 0;
454  pkx.l(t)$((-xtelec("capital",t))$shortrun) = 1;
455
456  ra.l = 
457     (-sam("capital","roi")+sum(xt,(-xtelec("capital",xt))$(not shortrun))*pkx.l(xt)
458       + sum(xt$shortrun, (-xtelec("capital",xt))*pkx.l(xt))
459       + sam("labor","ra")*pl.l
460       + sum(ff,(-sam("rent",ff))*pr.l(ff))
461       + sum(n, nrsupply(n)*pn.l(n))
462       + (carblim*pcarb.l)*carblim
463       + sum(xt$limit(xt), limit(xt)*plim.l(xt))
464       - sum(t$quota(t), pele.l*ele.l(t)*tau.l)
465       - (pc.l*phi_ls.l)$dd;
```
govt.l$dd = (carblim*pcarb.l)$carblim + pc.l*phi_ls.l
+ (-sam("roi","ra")/(1+tc0$dd))*c.l*(pc.l/(proi.l*(1+tc0*phi_tc.l)$dd)
/(1+tc0$dd))**esub_c*pc.l*tc0*phi_tc.l;

* Check the benchmark:
  * - marginal of all active activities must be zero
  * - marginal of all positive prices must be zero
  * - marginal of all positive incomens must be zero

mcp_hybrid.iterlim = 0;
solve mcp_hybrid using mcp;

* Relax iteration limit for counterfactual policy analysis
mcp_hybrid.iterlim = 4000;

*===========================================================================
* Analysis of policy scenarios (as laid out in the paper)
* (i) gradual nuclear phase-out
* (ii) target quota for renewables (green quota)
* (iii) carbon taxation (environmental tax reform)

* Define report parameters
parameter
ev(*) Equivalent variation in income
supply(*,*) Electricity supply by technology
carbtax(*) Carbon permit price
subsidy Subsidy rate on electricity from renewables
report Report default parameter;

scalar epsilon /1.e-5/;

*===========================================================================
* Scenario 1: Gradual nuclear phase-out

set nsc Nuclear phase scenarios / 0, 25, 50, 75, 100/;

parameter limit_0 Base year capacity limits;
limit_0("nuclear") = limit("nuclear");

loop(nsc,
Assign available capacity for nuclear power

\[
\text{limit}(\text{"nuclear"}) = (1 - (\text{ord(nsc)}-1)/(\text{card(nsc)}-1)) \times \text{limit}_0(\text{"nuclear"});
\]

Display limit;

If nuclear capacity is set to zero, assure complete nuclear phase out

\[
\text{if } (\text{not limit(\text{"nuclear"})),}
\]

\[
\text{ele.fx(\text{"nuclear"}) = 0;}
\]

solve mcp_hybrid using mcp;

\[
\text{supply(nsc,t) = ele.l(t) + \text{epsilon};}
\]

\[
\text{ev(nsc) = 100} \times (\text{c.l-1}) + \text{epsilon;}
\]

* Re-initialize parameterization for subsequent scenarios

\[
\text{limit(\text{"nuclear"}) = \text{limit}_0(\text{"nuclear"});}
\]

\[
\text{ele.lo(\text{"nuclear"}) = 0; ele.up(\text{"nuclear"}) = +inf; ele.l(\text{"nuclear"})=xtelec("ele","nuclear");}
\]

Scenario 2: Green quotas

Note: We start from the base year situation without binding target share and then increase the share iteratively by 5%.

The descriptive text for scenario set elements captures
the actual target level of green electricity as percent in overall electricity production (base year quota is 13%).
The plot-command picks up the descriptive text as scenario labels when produce a graphical exposition of results.

Assign initial level values for variables

\[
roi.l = 1; \quad ele.l(xt) = \text{xtelec("ele",xt); \quad } s.l(ff) = 1; \quad c.l = 1; \\
proi.l = 1; \quad pele.l = 1; \quad pf.l(ff) = 1; \quad pl.l = 1; \quad pk.l = 1; \quad pr.l(ff) = 1; \\
pkx.l(t)$((-\text{xtelec("capital",t)}$\text{shortrun}) = 1; \quad plim.l(t) = 0; \\
\]

Install lower bounds on prices to avoid division by zero in MCP formulation

\[
\text{proi.lo} = 1e^{-5}; \quad \text{pele.lo} = 1e^{-5}; \quad \text{pf.lo(ff)} = 1e^{-5}; \quad \text{pl.lo} = 1e^{-5}; \quad \text{pk.lo} = 1e^{-5}; \quad \text{pr.lo(ff)} = 1e^{-5}; \\
\text{pkx.lo(t)$((-\text{xtelec("capital",t)}$\text{shortrun}) = 1e^{-5}; \quad \text{pc.lo} = 1e^{-5}; \\
\]

Assign target shares for renewables in electricity production

\[
\text{share} = \min(1, (\text{share}_0 + 20/100\ast (\text{ord(qsc)}-1)/(\text{card(qsc)}-1))); \\
\]

solve \text{mcp_hybrid} using \text{mcp};

\[
\text{supply(qsc,t)} = \text{ele.l(t)} + \epsilon; \\
\text{ev(qsc)} = 100\ast (\text{c.l}-1) + \epsilon; \\
\text{subsidy(qsc)} = 100\ast \text{tau.l} + \epsilon; \\
\]

\$\text{setglobal labels qsc}
\$\text{report(qsc,"ev") = ev(qsc);}
\$\text{setglobal gp_opt2 "set title 'Welfare changes'"}
\$\text{setglobal gp_opt3 "set xlabel 'Green quota in % of overall electricity supply'"}
\$\text{setglobal gp_opt4 "set ylabel 'Equivalent variation in income (%)'"}
\$\text{libinclude plot report}
\$\text{display report;}
\$\text{report(qsc,"ev") = 0;}
\$\text{setglobal gp_opt2 "set title 'Electricity supply by technology'"}
$setglobal gp_opt3 "set xlabel 'Green quota in % of overall electricity supply'"
$setglobal gp_opt4 "set ylabel 'Activity level of technologies'"
$libinclude plot supply

report(qsc,"subsidy") = subsidy(qsc);
$setglobal gp_opt2 "set title 'Subsidy on renewables'"
$setglobal gp_opt3 "set xlabel 'Green quota in % of overall electricity supply'"
$setglobal gp_opt4 "set ylabel 'Subsidy rate (% of electricity price)'"
$libinclude plot report
display report;
report(qsc,"subsidy") = 0;

* Re-initialize parameterization for subsequent scenarios
share = share_0;
quota(res) = no;
tau.fx = 0;

* Scenario 3: Carbon taxation (double dividend)

First re-specify base year (benchmark) to public good extension
mcp_hybrid.iterlim = 0;

dd = 1;
g.lo = 0; g.up = +inf; govt.lo = 0; govt.up = +inf;
g0 = 0.2 *(-sam("roi","ra"));
tc0 = g0/((-sam("roi","ra")) - g0);
display g0, tc0;

* Relax ficed variables

g.lo = 0; g.up = +inf; pg.lo = 0; pg.up = +inf; govt.lo = 0; govt.up = +inf;
p carb.lo = 0; pc arb.up = + inf;

* Initially, we assume that lump-sum transfers are active as the equal-yield instrument
phi_ls.l = 0; phi_ls.lo = -inf; phi_ls.up = +inf;
phi_tc.fx = 1;

* Assign base year carbon emissions (at shadow price of zero)
carb lim = sum(ff, sam(ff,ff)*carbon(ff));
p carb.l = 0;

* Benchmark replication check for the model with public good extension

* Initialize activities and prices
roi.l = 1; ele.l(xt) = xtelec("ele",xt); ele.l(zt) = 0; s.l(ff) = 1; c.l = 1;
proi.l = 1; pele.l = 1; pf.l(ff) = 1; pl.l = 1; pk.l = 1; pr.l(ff) = 1; pg.l = 1;
pxx.l(t) = -xtelec("capital",t)$shortrun = 1; plim.l(t)$limit(t) = 0;
pc.l = 1; pn.l(n) = 0; ra.l = c0; govt.l = g0;

* Install lower bounds on prices to avoid division by zero in MCP formulation
proi.lo = 1e-5; pele.lo = 1e-5; pf.lo(ff) = 1e-5; pl.lo = 1e-5; pk.lo = 1e-5; pr.lo(ff) = 1e-5;
pxx.lo(t) = -xtelec("capital",t)$shortrun = 1e-5; pc.lo = 1e-5; pg.lo = 1e-5;

* Check the re-specified benchmark:
  - marginal of all active activities must be zero
  - marginal of all positive prices must be zero
  - marginal of all positive incomens must be zero

mcp_hybrid.iterlim = 0;
solve mcp_hybrid using mcp;

* Relax iteration limit
mcp_hybrid.iterlim = 4000;

* Specification of carbon tax scenarios based on exogenous emission reduction targets
set csc Carbon abatement scenarios scenarios / 0, 5, 10, 15, 20/;

parameter carbon_0 Benchmark capacity limits;
parameter ev_ Report parameter for welfare changes;

carbon_0 = carblim;
display carbon_0;
loop(csc,
  Assign carbon emission limit
  carblim = (1 - 0.2*(ord(csc)-1)/(card(csc)-1))*carbon_0;
  Activate lump-sum transfer as recycling instrument
  phi_ls.l = 0; phi.ls.lo = -inf; phi.ls.up = +inf;
  phi.tc.fx = 1;
  solve mcp_hybrid using mcp;
  ev_(csc,"ls") = 100 * (c.l-1) + epsilon;
)
Activate consumption tax as recycling instrument

\[ \phi_{tc}.l = 1; \phi_{tc}.lo = -0.99; \phi_{tc}.up = +\infty; \]

\[ \phi_{ls}.fx = 0; \]

\[
\text{solve mcp\_hybrid using mcp;}
\]

\[
\text{ev}_csc(tc) = 100 \times (c.l - 1) + \text{epsilon};
\]

Re-initialize parameterization for subsequent policy scenarios

\[ \text{dd} = 0; \text{g0} = 0; \text{tc0} = 0; \]
5.2 MPSGE Formulation

$Title Static maquette of integrated TD/BU hybrid model

* Model formulation in meta-language MPSGE
* (see Rutherford 1995 for documentation)

===========================================================================

* Model code for stylized integrated bottom-up/top-down analysis of energy policies based on:

* ZEW Discussion Paper 05-28
* Integrating Bottom-Up into Top-Down:
* A Mixed Complementarity Approach
* Contact the authors at: boehringer@zew.de; rutherford@colorado.edu

============================================================================

* For plotting the results you must have installed the gnuplot-shareware (see http://debreu.colorado.edu/gnuplot/gnuplot.htm for downloads)

============================================================================

* List of parameters subject to sensitivity analysis
* The user can change the default settings.

* Choice of key elasticities:
* Elasticity of substitution in final consumption
$if not setglobal esub_c $setglobal esub_c 0.5

* Elasticity in gas supply
$if not setglobal esub_gas $setglobal esub_gas 1.5

* Elasticity in coal supply
$if not setglobal esub_coal $setglobal esub_coal 3

* Elasticity in oil supply
$if not setglobal esub_oil $setglobal esub_oil 1.5

* Choice of resource availability for renewables:
* (as a fraction of base-year total electricity production)
* Potential wind supply - (%) $if not setglobal p_wind $setglobal p_wind 10
42  * Potential solar supply - (%)  
43  $if not setglobal p_sun $setglobal p_sun 10  
44  
45  * Potential biomass supply - (%)  
46  $if not setglobal p_trees $setglobal p_trees 10  
47  
48  
49  * Cost disadvantage of initial slack technologies:  
50  * Wind energy premium (%)  
51  $if not setglobal c_wind $setglobal c_wind 10  
52  
53  * Solar energy premium (%)  
54  $if not setglobal c_solar $setglobal c_solar 10  
55  
56  * Biomass energy premium (%)  
57  $if not setglobal c_biomass $setglobal c_biomass 10  
58  
59  
60  * Other central model assumptions:  
61  * Time horizon (short, long)  
62  * N.B.: For short-run analysis capital is immobile across sectors  
63  $if not setglobal horizon $setglobal horizon long  
64  
65  #============================================================================  
66  #============================================================================  
67  
68  * Assign user-specific changes of default assumptions  
69  scalar shortrun Flag for short-run capital mobility/1/;  
70  
71  $if "%horizon%"="long" shortrun=0;  
72  
73  * Elasticities of substitution (ESUB)  
74  scalar esub_c Elasticity of substitution in final demand /%esub_c%/  
75  scalar esub_ele ESUB between electricity and oil in final demand /0.5/  
76  scalar esub_k_e ESUB between capital and energy in ROI production /0.5/  
77  scalar esub_l_ke ESUB between labor and other inputs in ROI production /0.8/;  
78  
79  set t Electricity Technologies (current and future)  
80  /coal,gas,nuclear,hydro,wind,solar,biomass/;  
81  
82  set xt(t) Existing technologies /coal,gas,nuclear,hydro/;  
83  
84  40
set nt(t) New vintage technologies /wind,solar,biomass/;
set ff Fossil fuel inputs /coa, gas, oil/;
set n Natural resources /wind, sun, trees/;
set res(t) Renewable energy sources /hydro, wind, solar, biomass/;

* The following data table describes an economic equilibrium in the base year:

table sam Base year social accounting matrix

<table>
<thead>
<tr>
<th></th>
<th>roi</th>
<th>coa</th>
<th>gas</th>
<th>oil</th>
<th>ele</th>
<th>ra</th>
</tr>
</thead>
<tbody>
<tr>
<td>roi</td>
<td>200</td>
<td>-5</td>
<td>-5</td>
<td>-10</td>
<td>-10</td>
<td>-170</td>
</tr>
<tr>
<td>coa</td>
<td>15</td>
<td></td>
<td></td>
<td></td>
<td>-15</td>
<td></td>
</tr>
<tr>
<td>gas</td>
<td>15</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-15</td>
</tr>
<tr>
<td>oil</td>
<td></td>
<td>30</td>
<td></td>
<td></td>
<td></td>
<td>-30</td>
</tr>
<tr>
<td>ele</td>
<td>-10</td>
<td></td>
<td>60</td>
<td></td>
<td></td>
<td>-50</td>
</tr>
<tr>
<td>capital</td>
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<td></td>
<td>100</td>
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<tr>
<td>labor</td>
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<td></td>
<td>130</td>
</tr>
<tr>
<td>rent</td>
<td></td>
<td>-110</td>
<td></td>
<td></td>
<td></td>
<td>130</td>
</tr>
<tr>
<td>rent</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>20</td>
</tr>
<tr>
<td>rent</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>;</td>
</tr>
</tbody>
</table>

parameter carbon(ff) Carbon coefficients /oil 1, gas 1, coa 2/;
scalar carblim Carbon target /0/;

parameter esub_ff(ff) Elasticity of substitution in fossil fuel production /gas %esub_gas%, coa %esub_coal%, oil %esub_oil%/;

* The following data tables describes electricity generation in the base year as well as the technology coefficients for technologies which are inactive in the base year (wind, solar, biomass). Inactive technologies are by defaults %c_****% more costly.

table xtelec Electricity technologies - extant (initially active)

<table>
<thead>
<tr>
<th></th>
<th>coal</th>
<th>gas</th>
<th>nuclear</th>
<th>hydro</th>
</tr>
</thead>
<tbody>
<tr>
<td>ele</td>
<td>20</td>
<td>20</td>
<td>12</td>
<td>8</td>
</tr>
<tr>
<td>roi</td>
<td>-1</td>
<td>-1</td>
<td>-8</td>
<td></td>
</tr>
<tr>
<td>gas</td>
<td></td>
<td>-15</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
coa -15
capital -4 -4 -4 -8;

table ntelec  Electricity technologies - new vintage (initially inactive)

<table>
<thead>
<tr>
<th></th>
<th>wind</th>
<th>solar</th>
<th>biomass</th>
</tr>
</thead>
<tbody>
<tr>
<td>ele</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>roi</td>
<td>-.2</td>
<td>-.3</td>
<td>-.4</td>
</tr>
<tr>
<td>capital</td>
<td>-.9</td>
<td>-.8</td>
<td>-.7</td>
</tr>
<tr>
<td>wind</td>
<td>-1.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>sun</td>
<td></td>
<td>-1.0</td>
<td></td>
</tr>
<tr>
<td>trees</td>
<td></td>
<td></td>
<td>-1.0</td>
</tr>
</tbody>
</table>

* Adjust the cost coefficients for initially inactive technologies according to user assumptions:

set xk /roi, capital/;

ntelec(xk,"wind") = ntelec(xk,"wind") * (100+c_wind)/110;
ntelec(xk,"solar") = ntelec(xk,"solar") * (100+c_solar)/110;
ntelec(xk,"biomass") = ntelec(xk,"biomass") * (100+c_biomass)/110;

* Specify limits (resource or policy constraints) to the availability of technologies

parameter limit  Electriciry supply limits on extant technologies /

nuclear 12
hydro 8 /

parameter nrsupply(n) Natural resource supplies (fraction of base output)/

wind %p_wind%
sun %p_sun%
trees %p_trees% /

nrsupply(n) = nrsupply(n)/100 * sam("ele","ele");

parameter c0  Baseyear final consumption;

c0 = (-sam("roi","ra")-sam("ele","ra")-sam("oil","ra");

set quota(t) Flag for technologies contributing to green quota;
quota(t) = no;

scalar share  Target share for green quota /0/;

* By default we might set target share for green quota at base year level
share = sum(t$res(t), xtelec("ele",t))/sum(t, xtelec("ele",t));
display share;

scalar
dd Flag for double dividend policy analysis /0/,
ls Flag for lump-sum revenue-recycling /0/,
vat Flag for VAT revenue recycling /0/,
g0 Base year public consumption /0/,
tc0 Base year consumption tax /0/;

* MPSGE formulation of the hybrid model
$ontext
$model:mps_hybrid

$sectors:
roi ! Aggregate output
ele(t) ! Production levels for electricity by technology
s(ff) ! Fossil fuel supplies
c ! Aggregate consumption (utility) formation
g$dd ! Public good provision

$commodities:
proi ! Price of aggregate output
pele ! Price of electricity
pf(ff) ! Price of oil and gas
pl ! Wage rate
pk ! Price of malleable capital for X (and NT elec)
pr(ff) ! Rent on fossil fuel resources
pn(n) ! Rent on natural resources
pc ! Consumption (utility) price index
pg$dd ! Price of public consumption
plim(t)$limit(t) ! Shadow price on electricity expansion
pkz(t)$((-xtelec("capital",t))$shortrun) ! Price of capital to extant technologies
pcarb$carblim ! Carbon tax rate

$consumers:
ra ! Representative household
govt$dd ! Government

$auxiliary:

tau$card(quot) ! Uniform subsidy rate on renewable energy
phi_ls$dd ! Lump-sum recycling
phi_tc$dd ! Consumption tax recycling

* Aggregate output:

$prod:roi s:esub_l_ke ke:esub_k_e
o:poi q:sam("roi","roi")
i:pl q:-(sam("labor","roi"))
i:pk q:-(sam("capital","roi")) ke:
i:pele q:-(sam("ele","roi")) ke:

* Extant electricity:

$prod:ele(xt)
o:pele q:1 r:a:ra n:tau$quota(xt) m:(-1)$quota(xt)
i:poi q:-(xtelec("roi",xt)/xtelec("ele",xt))
i:pf(ff) q:-(xtelec(ff,xt)/xtelec("ele",xt))
i:pkx(xt)$shortrun q:-(xtelec("capital",xt)/xtelec("ele",xt))
i:pk$(not shortrun) q:-(xtelec("capital",xt)/xtelec("ele",xt))
i:plim(xt)$limit(xt) q:1

* New vintage electricity:

$prod:ele(nt)
o:pele q:1 a:ra n:tau$quota(nt) m:(-1)$quota(nt)
i:poi q:-(ntelec("roi",nt))
i:pk q:-(ntelec("capital",nt))
i:pn(n) q:-(ntelec(n,nt))

$prod:s(ff) s:0 r:esub_ff(ff) xl(r):0
o:pf(ff) q:=(ff,ff)
i:pcarb$carblim q:(carbon(ff)*sam(ff,ff))
i:poi q:-(sam("roi",ff)) xl:
i:pl q:-(sam("labor",ff)) xl:
i:pr(ff) q:-(sam("rent",ff)) r:

$prod:c s:esub_c e:esub_ele
o:pc q:0
\[
i:proi \quad q:\left(-\text{sam}("roi","ra")/\left(1+tc0$dd}\right)\right) \quad p:\left(1+tc0$dd\right)
\]

\[
a:govt$dd \quad n:phi_tc$dd \quad m:tc0$dd
\]

\[
i:pele \quad q:\left(-\text{sam}("ele","ra")\right) \quad e:
\]

\[
i:pf("oil") \quad q:\left(-\text{sam}("oil","ra")\right) \quad e:
\]

\[
$\text{demand:ra}$
\]

\[
d:pc \quad q:c0
\]

\[
e:pk \quad q:\left(-\text{sam}("capital","roi")+\text{sum}(xt,\left(-\text{xtelec}("capital",xt)\right))\right)\left(\text{not shortrun}\right)
\]

\[
e:pkx(xt)$\text{shortrun} \quad q:\left(-\text{xtelec}("capital",xt)\right)
\]

\[
e:pl \quad q:\left(\text{sam}("labor","ra")\right)
\]

\[
e:pr(ff) \quad q:\left(-\text{sam}("rent",ff)\right)
\]

\[
e:pn(n) \quad q:\text{nrsupply}(n)
\]

\[
e:p\text{carb$carblim$}(\text{not dd}) \quad q:\text{carblim}
\]

\[
e:p\text{lim}(xt)$\text{limit}(xt) \quad q:\text{limit}(xt)
\]

\[
e:pc$dd \quad q:\left(-1\right) \quad r:phi_ls$dd
\]

\[
$\text{demand:govt$dd}$
\]

\[
d:pg \quad q:g0
\]

\[
e:pc \quad q:1 \quad r:phi_ls
\]

\[
e:p\text{carb$carblim} \quad q:\text{carblim}
\]

\[
$\text{prod:govt$dd}$
\]

\[
0:pg \quad q:g0
\]

\[
i:proi \quad q:g0
\]

\[
$\text{constraint:tau$card(quotas)}$
\]

\[
\text{sum}(t$\text{res}(t),\text{ele}(t)) = e = \text{share}*\text{sum}(t,\text{ele}(t));
\]

\[
$\text{constraint:phi_ls$dd}$
\]

\[
g = e = 1;
\]

\[
$\text{constraint:phi_tc$dd}$
\]

\[
g = e = 1;
\]

\[
$\text{offtext}$
\]

\[
$\text{sysinclude mpsgetset mps_hybrid}$
\]

\[
* \quad \text{In the base year new-vintage technologies are inactive}
\]

\[
* \quad \text{and the prices of backstop natural resources are zero}
\]

\[
* \quad \text{Extant technologies with capacity limits are assumed to}
\]

45
operate at the upper bound with a zero shadow value in the base year

```
iele.l(nt) = 0;
ppn.l(n) = 0;
plim.l(xt) = 0;

ele.l(xt) = xtelec("ele", xt);
```

Benchmark replication check

```
mps_hybrid.iterlim = 0;
$include mps_hybrid.gen
solve mps_hybrid using mcp;
```

```
display "The precision of the benchmark dataset is: ", mps_hybrid.objval;
abort$(ABS(mps_hybrid.objval) gt 1e-4) "MPSGE model does not calibrate";
```

```
mps_hybrid.iterlim = 4000;
```

Analysis of policy scenarios (as laid out in the paper)

(i) gradual nuclear phase-out
(ii) target quota for renewables (green quota)
(iii) carbon taxation (environmental tax reform)

Define report parameters

```
parameter
ev(*) Equivalent variation in income
supply(*,*) Electricity supply by technology
carbtax(*) Carbon permit price
subsidy Subsidy rate on electricity from renewables
report Report default parameter;
```

```
scalar epsilon /1.e-5/;
```

Scenario 1: Gradual nuclear phase-out
set nsc Nuclear phase scenarios / 0, 25, 50, 75, 100/;

parameter limit_0 Base year capacity limits;
limit_0("nuclear") = limit("nuclear");

loop(nsc,

Assign available capacity for nuclear power
limit("nuclear") = (1 - (ord(nsc)-1)/(card(nsc)-1))*limit_0("nuclear");

If nuclear capacity is set to zero, assure complete nuclear phase out
if ((not limit("nuclear")),
ele.fx("nuclear") = 0;
);

$include mps_hybrid.gen
solve mps_hybrid using mcp;
supply(nsc,t) = ele.l(t) + epsilon;
ev(nsc) = 100 * (c.l-1) + epsilon ;

$setglobal labels nsc
$setglobal gp_opt0 "set data style linespoints"
$setglobal gp_opt1 "set key below"
report(nsc,"ev") = ev(nsc);
$setglobal gp_opt2 "set title 'Welfare changes'"
$setglobal gp_opt3 "set xlabel 'Nuclear capacity reduction (% vis--vis BaU)'
$setglobal gp_opt4 "set ylabel 'Equivalent variation in income (%)'
$libinclude plot report
display report;
report(nsc,"ev") = 0;

$setglobal gp_opt2 "set title 'Electricity supply by technology'"
$setglobal gp_opt3 "set xlabel 'Nuclear capacity reduction (% vis--vis BaU)'
$setglobal gp_opt4 "set ylabel 'Activity level of technologies'
$libinclude plot supply

* Re-initialize parameterization for subsequent scenarios
limit("nuclear") = limit_0("nuclear");
ele.lo("nuclear") = 0; ele.up("nuclear") = +inf;
ele.l("nuclear")=xtelec("ele","nuclear");

Scenario 2: Green quotas

set qsc Green quota scenarios / 0 13, 5 18, 10 23, 15 28, 20 33/;

* Note: We start from the base year situation without binding target share and then increase the share iteratively by 5%.

The descriptive text for scenario set elements captures the actual target level of green electricity as percent in overall electricity production (base year quota is 13%).

The plot-command picks up the descriptive text as scenario labels when produce a graphical exposition of results.

parameter share_0 Base year renewable share;
share_0 = share;
quota(res) = yes;

loop(qsc,
* Assign target shares for renewables in electricity production
share = min(1, (share_0 + 20/100* (ord(qsc)-1)/(card(qsc)-1)));
);$include mps_hybrid.gen
solve mps_hybrid using mcp;
supply(qsc,t) = ele.l(t) + epsilon;
ev(qsc) = 100 * (c.l-1) + epsilon;
subsidy(qsc) = 100*tau.l + epsilon;

);$setglobal labels qsc
report(qsc,"ev") = ev(qsc);
$setglobal gp_opt2 "set title 'Welfare changes'
$setglobal gp_opt3 "set xlabel 'Green quota in % of overall electricity supply'
$setglobal gp_opt4 "set ylabel 'Equivalent variation in income (%)'"
$libinclude plot report
display report;
report(qsc,"ev") = 0;
\$setglobal gp\_opt2 "set title 'Electricity supply by technology'"
\$setglobal gp\_opt3 "set xlabel 'Green quota in % of overall electricity supply'"
\$setglobal gp\_opt4 "set ylabel 'Activity level of technologies'"
\$libinclude plot supply

\$setglobal gp\_opt2 "set title 'Subsidy on renewables'"
\$setglobal gp\_opt3 "set xlabel 'Green quota in % of overall electricity supply'"
\$setglobal gp\_opt4 "set ylabel 'Subsidy rate (% of electricity price)'"
\$libinclude plot report

display report;

\$exit

* Re-initialize parameterization for subsequent scenarios

share = share\_0;
quota(res) = no;
\$exit

* Scenario 3: Carbon taxation (double dividend)

First re-calibrate base year (benchmark) to public good extension

mps\_hybrid.iterlim = 0;

\$exit

* Initially, we assume that lump-sum transfers are active

\$exit

Assign base year carbon emissions (at shadow price of zero)

carblim = sum(ff, sam(ff,ff)*carbon(ff));
p\_carb.l = 0;

Benchmark replication check for the model with public good extension

\$exit

Initialize activities and prices

roi.l = 1; ele.l(xt) = xtelec("ele".,xt); ele.l(nt) = 0; s.l(ff) = 1; c.l = 1;

pkx.l(t)$(\$xtelec("capital",t))$shortrun) = 1; plim.l(t)$limit(t) = 0;
pc.l = 1; pn.l(n) = 0; ra.l = c0; govt.l = g0;

mps_hybrid.iterlim = 0;
$include mps_hybrid.gen
solve mps_hybrid using mcp;

display "The precision of the re-specified benchmark dataset is:"", mps_hybrid.objval;
abort$(ABS(mps_hybrid.objval) gt 1e-4)"MPSGE model does not calibrate";

mps_hybrid.iterlim = 4000;

* Relax iteration limit
mps_hybrid.iterlim = 4000;

* Specification of carbon tax scenarios based on exogenous emission reduction targets
set csc Carbon abatement scenarios scenarios / 0, 5, 10, 15, 20/;

parameter carbon_0 Benchmark capacity limits;
parameter ev_ Report parameter for welfare changes;

carbon_0 = carblim;
display carbon_0;

loop(csc,
    * Assign carbon emission limit
carblim = (1 - 0.2*(ord(csc)-1)/(card(csc)-1))*carbon_0;
    * Activate lump-sum transfer as recycling instrument
    phi_ls.l = 0; phi_ls.lo = -inf; phi_ls.up = +inf;
    phi_tc.fx = 1;
    $include mps_hybrid.gen
    solve mps_hybrid using mcp;
    ev_(csc,"ls") = 100 * (c.l-1) + epsilon;
    * Activate consumption tax as recycling instrument
    phi_tc.l = 1; phi_tc.lo = -0.99; phi_tc.up = +inf;
    phi_ls.fx = 0;
    $include mps_hybrid.gen
    solve mps_hybrid using mcp;
    ev_(csc,"tc") = 100 * (c.l-1) + epsilon;
);

$setglobal labels csc
$\texttt{setglobal gp\_opt2 \ "set title 'Welfare changes'\"}$

$\texttt{setglobal gp\_opt3 \ "set xlabel 'Carbon emission reduction (in \% vis--vis base year)\"}$

$\texttt{setglobal gp\_opt4 \ "set ylabel 'Equivalent variation in income (\%)\"}$

$\texttt{libinclude plot ev_}$

$\texttt{display ev_}$

$\texttt{ev\_(csc,\"tc\") = 0\; ev\_(csc,\"ls\") = 0; \}$

\* Re-initialize parameterization for subsequent policy scenarios

$\texttt{dd = 0; g0 = 0; tc0 = 0;}$