

# Linking with politics

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Top-down, RIP

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\* Not asserting and definitely not wishing, just paraphrasing

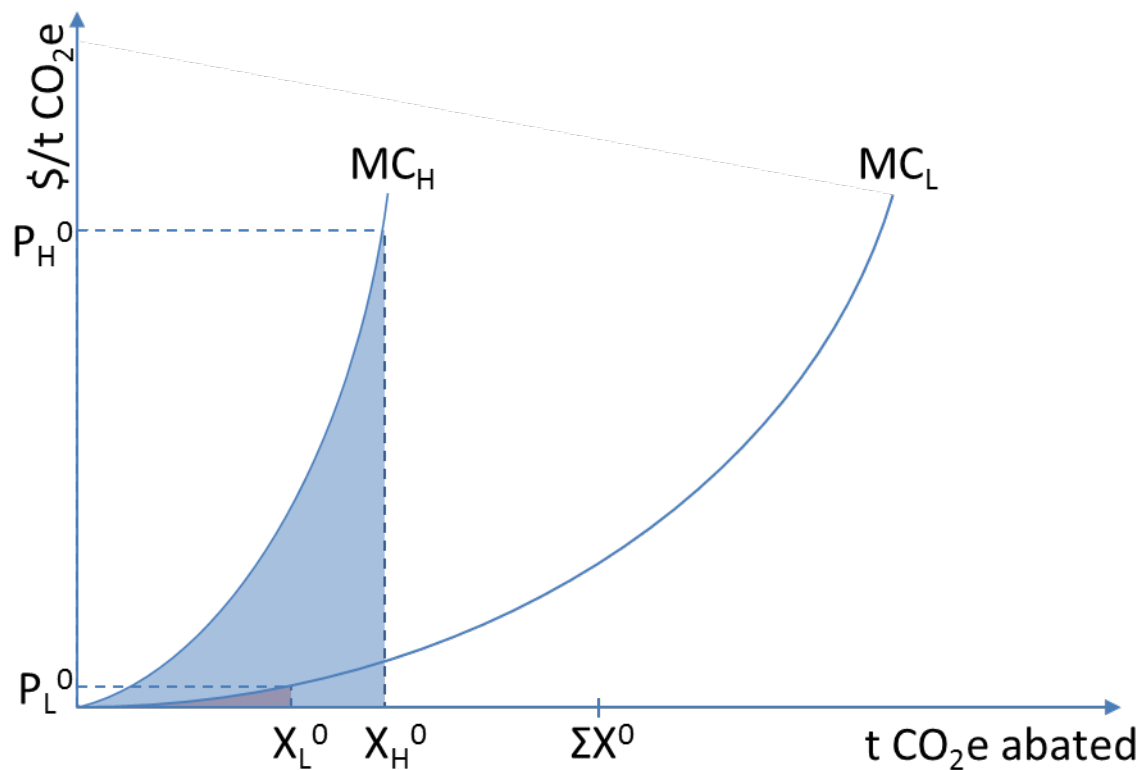
Bottom-up

# Bottom-up\*

\* Not asserting it's the solution to everything, just paraphrasing

# Unequal targets and costs before linkage

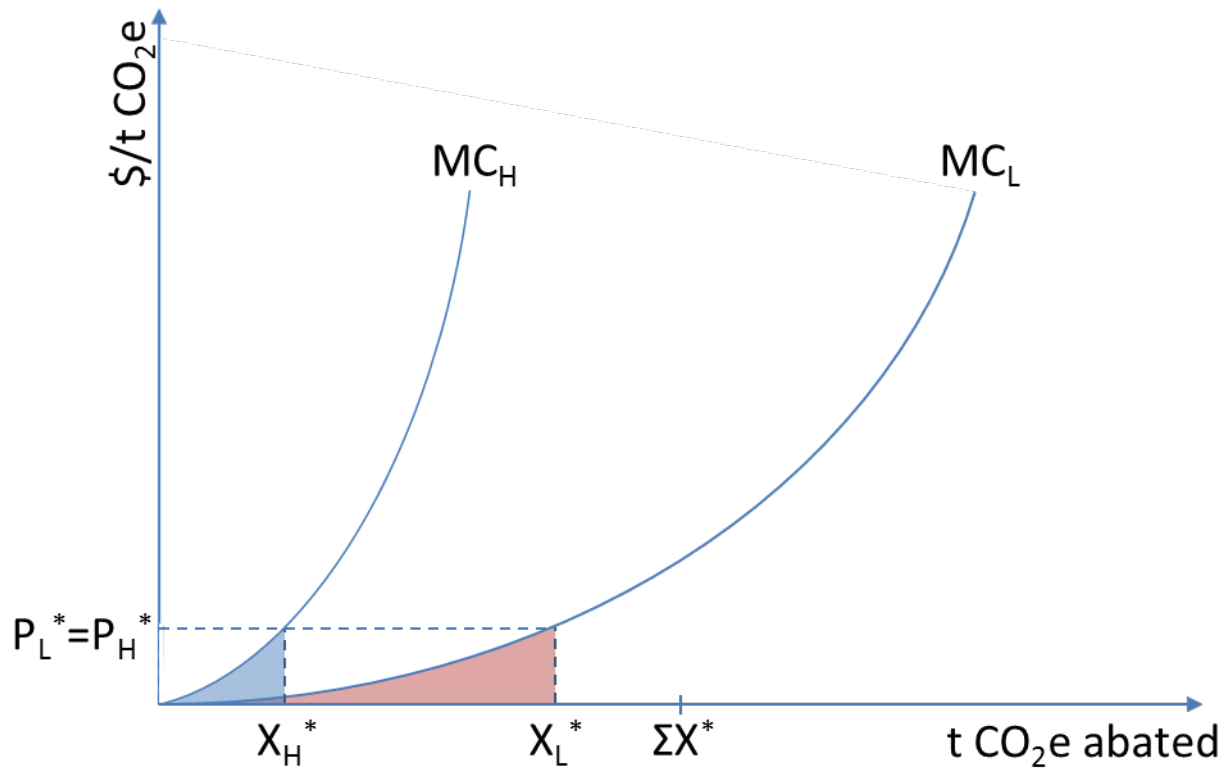
Large potential Pareto improvements from trade across domestic efforts



Large costs without linkage

# Linkage has potential to decrease abatement costs

Higher ambition in low-cost countries, supported by funds from high-cost countries

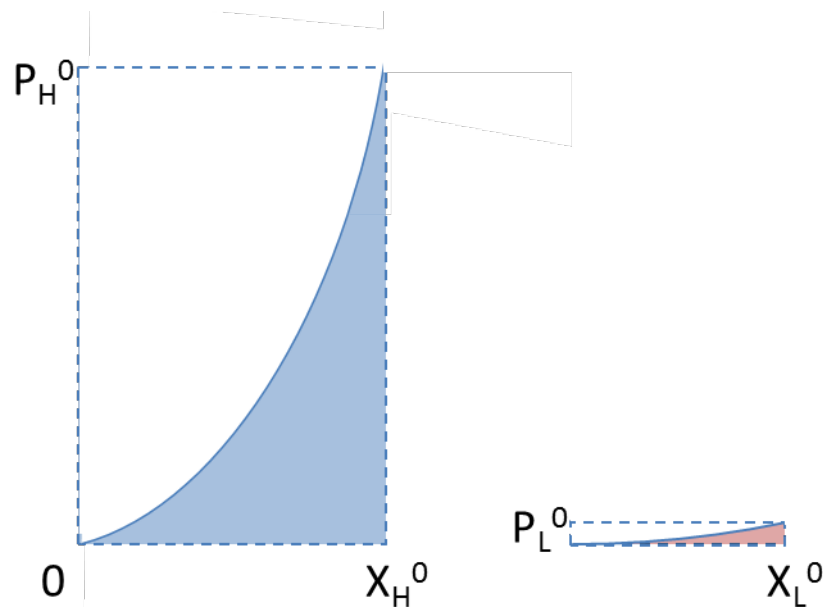


Equal total abatement, lower total cost

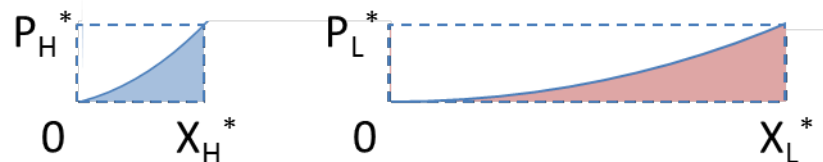
# Significant gains from trade

Potential Pareto improvements, supported by monetary transfers

Total costs before linkage:



Total costs after linkage:



Need stable targets & financial flows



Linkage promises  
same abatement  
at lower cost\*

\* Or more abatement at equal cost, or anything in between

# Linkage creates winners and losers

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- Within a cap-and-trade system
  - Net buyers gain from lower price
  - Net sellers gain from higher price
- Across cap-and-trade systems
  - Total costs to low-cost country rise
  - Total costs to high-cost country fall

Solid economics, uncertain politics

## Four obstacles to successful linkage

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- Potential for gaming of targets
  - Prospect of linkage may lower levels of ambition
- Need for ‘financial transfers’
  - Domestic political support key
- Difficulty of close regulatory coordination
  - From the mundane (short vs. metric tons)...
  - ... to the more fundamental (which offset credits to allow)
- Incompatibility with other domestic objectives
  - Desire for higher carbon prices vs cost-effectiveness

Which top-down problems does  
bottom-up linkage solve?

# Linkage train has left the station

Developed-developed country vs developed-developing linkages

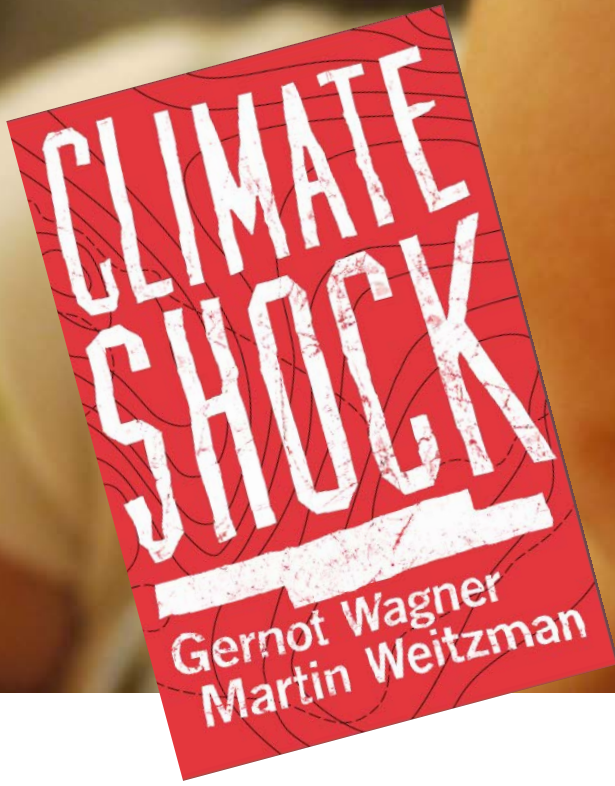
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- California & Quebec
- Australia & New Zealand
- EU & Australia-New Zealand
- ...

Build, test, and prove viability of  
strong domestic systems

VS

Leverage existing systems for broader  
carbon market sooner



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