Linkage: A Promising Approach to Achieving the Goals of the Durban Platform

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Linkage in a Bottom-Up System

- Form of ADP as yet unclear
  - Appears to be support for a bottom-up agreement
  - Recognizes diversity of countries and regions as well as heterogeneity in desired approaches to mitigation

Context for Bottom Up Approach

- Tension between ambition and political realities
  - Top down approach can be ambitious but may not attract sufficient participation
  - Bottom up approach may encourage broad participation but may not achieve needed emission reductions

Top Down Coverage

- Kyoto Protocol Second Commitment Period, 2013 – 2020
- EU and Australia participating

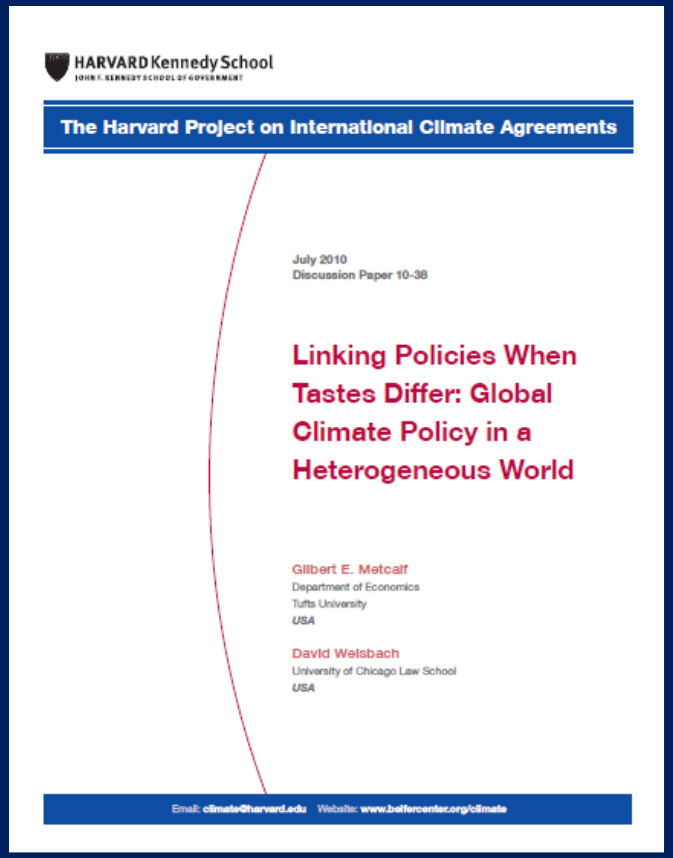
- Covers 14 percent of global emissions

Bottom Up System Could Build on Existing Mechanisms

- Multi-National Systems
  - EU-ETS
- National Systems
  - Australia, New Zealand, Korea, China (tax), South Africa, India
- Sub-National Systems
  - California, RGGI, WCI, British Columbia, Quebec, Tokyo, China (PMR)

Linkage in a Heterogeneous World

- National (or sub-national) policies are likely to be heterogeneous
- A global architecture should accommodate this heterogeneity
- Linkage: "policies that allow for regional carbon regulations to interact to narrow or eliminate differences in the marginal cost of abatement between different regions or countries"



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Linking Policies When Tastes Differ: Global Climate Policy in a Heterogeneous World

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Linked Systems

- Linking could be part of a top down global architecture or an organic bottom up construction – or a hybrid system
- Linkage addresses different issues:
  - Offers opportunities for cost effective emission reductions
  - Contributes to price harmonization and so addresses leakage concerns
  - Potential source of international climate finance

Implications for Linkage

- Linkage can make both countries better off
- Magnitude of payments depends on each country's reduction obligation
- Potential for winners and losers within countries as carbon price equilibrates
- Linkage can be a challenge for national autonomy
- Possibility of linkage creates incentives for countries to set low reduction targets

Linkage Opportunities

- Cap and trade systems
- Carbon charge systems
- Emission reduction credit systems
- Command and control regulations

Linkage Design Considerations

- Permit base
- Offsets
- Upstream v. downstream coverage
- Permit allocation rules
- Cost containment measures
- Enforcement mechanisms
- Compliance periods

- Linking cap and trade systems well understood
- Coordinating system design important

Linking Cap and Trade with Tax Systems

- In principle linkage is possible
  - Permits used in lieu of tax payments
  - Emission Tax Payment Credits (ETPCs) used in lieu of permits
  - ETPCs issued for carbon tax payments in excess of its emissions
- Unrestricted linkage unlikely
  - Arbitrage converts cap and trade to a tax
- Payments are transfers with political implications

Linkage Through Emission Reduction Credit Systems

- Linkage with cap and trade exists (CDM, JI)
- Linkage with tax systems straightforward
  - ERCs in lieu of taxes
- All problems with ERCs (e.g. additionality) apply equally to both linkage systems

Linking with Regulatory Systems

- Quantity limits could give rise to ETPC-like credits that could be used to link with cap and trade or tax systems
  - Reductions in excess of required reductions give rise to credits
  - Similar approach possible for intensity standard systems

Linking with Regulatory Systems

- Challenges for technology mandates
  - Additionality
  - Determining emission reductions associated with mandate
- Linkage in principle possible
  - Some mandates might provide linkage opportunities (e.g. fuel economy standards in excess of mandated level)

Linkage: Benefits and Challenges

- Linkage opportunities exist in a heterogeneous world
- Benefits of linkage include
  - Lower cost of emission reductions
  - Reduced price volatility in cap and trade systems
  - Greater market liquidity in trading systems
  - Reduced market power potential
  - Facilitates international climate finance flows

Linkage: Benefits and Challenges

- Challenges include
  - Weak systems transmit low prices to other systems
  - Political will for full harmonization may not exist
  - Streamlining process for project or process approval will be essential for scaling up

Linkage and the ADP

- Incremental approach through bottom-up systems linking on a case by case basis reflects national heterogeneity and encourages participation
- Could provide incentives for countries to develop market based mechanisms that support climate finance flows to their countries
- Could serve as the basis of an international regime developed through an organic process that respects national sovereignty
  - Real world ambition v. legislated ambition
- Linkage facilitates a top-down, bottom-up, or hybrid system

For More Information

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http://works.bepress.com/gilbert_metcalf/

http://belfercenter.ksg.harvard.edu/publication/20264/linking_policies_when_tastes_differ.html