

Strategic Climate Cooperation and Greenhouse Gas Price Coordination

Over the past year, policymakers, academics and non-governmental organizations on both sides of the Atlantic have begun talking about how to coordinate policies to reduce methane emissions from the oil and gas sector. While this may seem like an obscure, technical topic, moving forward with this initiative is critical, as the implications for climate cooperation – not just for the US and EU, but for the global community – are profound. In this article, we explore the reasons behind this assertion.

Climate change poses a global incentive problem: while individual nations bear the full costs of their climate policies – including the costs of energy transitions and the impact of higher energy prices on their competitive industries – most of the benefits of such policies accrue to the global community. As a result, self-interest too often leads to inadequate action.

Current international climate agreements, based on collective targets and nationally determined contributions, do not adequately address the free-rider challenge, which reduces their effectiveness. In contrast, common price agreements offer several advantages: ease of measurement, continuous monitoring, comparability, flexible implementation, and enforceability through mechanisms such as Carbon Border Adjustment Mechanisms and the conditional use of international climate funds. The reciprocity inherent in such a common price agreement is essential for climate cooperation, and reciprocity has been a helpful factor in the success of other international agreements – from minimum corporate taxes to trade to disarmament (Cramton et al., 2017). Reciprocity protects cooperators from potential exploitation and fosters an environment conducive to cooperation, even for self-interested parties (Ostrom, 1990; Schmidt and Ockenfels, 2021).

A climate club provides an opportunity to initiate a common pricing agreement (Nordhaus, 2015; Snower, 2022), although it is important to recognize that cooperation and enforcement mechanisms evolve incrementally. The value of a multilateral or bilateral agreement should be judged not on its immediate impact but on its potential to dynamically change the landscape of cooperation in an area of inadequate, fragmented and asymmetric climate policies. A global, ambitious carbon price may take time to become feasible, but striving to improve cooperation is beneficial, imperative and possible.

There are a number of key strategies:

Start with bilateral engagement. Effective climate cooperation requires that the US and the EU coordinate on a carbon price floor and ultimately use their collective sanctioning and rewarding power to motivate and enforce cooperation from reluctant governments (Farrokhi and Lashkaripour, 2022). Getting the US on board is currently difficult, but its climate policy remains in flux, and the 2025 overhaul of the tax code will require new sources of revenue. Carbon pricing revenues are a plausible candidate (Clausing and Sarin, 2023). Moreover, a carbon price and a carbon border adjustment would support green technologies and other US industries, such as steel, because of the lower carbon intensity of their production compared to competitors. Carbon pricing is also essential for efficient abatement, and the US is unlikely to meet its climate goals without it.

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Start with a flexible and modest price floor. An initial minimum price agreement can be only modestly ambitious because it can be implemented on top of all existing and planned national and international climate policies, making it more palatable. Once coordination is established, the price can be adjusted. Negotiation flexibility includes targeting specific industries or sectors, such as electricity, for which implementation is straightforward and reliable. It also includes setting an average minimum price that allows participants to exempt some sectors at the expense of others.

Start with a methane agreement. There is currently a unique window of opportunity for a transatlantic methane agreement, which could be a critical step toward kick-starting climate cooperation. Reducing methane emissions is essential to limiting the rise of global temperatures to unacceptable levels, and the oil and gas sector has the most significant low-cost abatement potential. Under the Inflation Reduction Act (IRA), the US has introduced a methane emissions fee as a backstop to new methane regulations in the oil and gas sector. In a parallel, uncoordinated process, the EU is implementing new methane regulations for fossil fuels, including a proposal to sanction imports from countries that fail to meet specific regulatory standards.

Coordinating these transatlantic efforts with similar goals and scope would encourage oil and gas exporters to adopt regulations comparable to those in the US and the EU or face a border adjustment fee on exports to both jurisdictions (Böhringer et al., 2016). The climate impact would be significant, and if broadened to include other key importers, its impact would be comparable to the overall effect of the recent IRA. Still, the impact on energy prices would be small because of the low abatement costs and the ability of importers to substitute relatively clean supply sources (Rystad, 2023). Most importantly, a coordinated methane policy would help build climate cooperation, defuse recent friction over divergent policy approaches and pave the way for alignment in other sectors, which could ultimately motivate further coordinated climate policy action globally (Clausing et al., 2023; Clausing and Wolfram, 2023).

In light of the above, coordination on greenhouse gas pricing should be pursued by focusing first on the US and the EU, tailoring initial proposals to minimize political and economic barriers to agreement, and building on existing parallel developments. This approach can significantly strengthen the critical process of international climate cooperation. It is hard to overstate the potential benefits of this path to climate cooperation for the US, the EU and the world.

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