

## COP28: Strategic climate cooperation

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Climate change is the mother of all global externalities: The actions (or inactions) of one actor have an impact on the entire planet. This raises a central problem of collective action: while individual nations bear the full costs of their climate policies - both economically and politically - the benefits accrue to the global community. Without sufficient incentives for cooperative behavior, self-interest leads to insufficient progress in climate protection. These days, the heads of state and government are meeting at COP28 in Dubai. However, the outcomes of such meetings, which include collective targets and national voluntary commitments, do not prevent free-riding so that greenhouse gas (GHG) emissions continue to rise. However, through joint pricing of GHGs and border adjustment mechanisms, willing countries can create stronger incentives for political action. For example, the more countries that join the European efforts for carbon pricing in combination with a border adjustment mechanism (CBAM), the greater the incentives for the rest of the world to introduce carbon prices themselves in order to avoid tariffs on their exports. A joint agreement on GHG pricing offers decisive advantages for mitigating climate change: prices as a measure of political efforts can be measured and compared relatively easily, strong incentives for mutual control of pricing policies are created, and the "stick" of border adjustment can be combined with the "carrot" of access to climate finance. Such reciprocity mechanisms are key elements for the success of international agreements, from minimum corporate taxes to trade agreements and disarmament.

We propose the following principles for climate cooperation: *First*, key jurisdictions, such as the US and the EU, should step up their cooperation efforts. The US is currently pursuing a subsidy-based approach, but the upcoming review of the tax system in 2025, which will take place in an environment of increased fiscal pressure and higher interest rates, will require new revenue streams and provide a political opportunity for a breakthrough on GHG pricing. Industry resistance may be limited as a carbon price combined with a carbon border adjustment could improve the competitiveness of US industry due to the lower carbon intensity of US production compared to production in many foreign locations. The pricing of CO<sub>2</sub> is also an essential prerequisite for more efficient emission reductions, without which the US will not be able to achieve its climate targets. *Secondly*, international cooperation should start with a flexible CO<sub>2</sub> minimum price, including the possibility of lower minimum prices for poorer countries. In addition, price floors could initially be introduced only in the energy sector, where implementation should be easier, or in the industrial sector, which has proven difficult to decarbonize and where price coordination would level the international playing field. *Thirdly*, limiting methane emissions in the oil and gas sector is a promising starting point for cooperation. Both the US and Europe have recently tightened regulation in this sector. Coordinating these transatlantic efforts would encourage oil and gas exporters to introduce regulations comparable to those in the US and the EU, as otherwise a border adjustment levy would become due.

Reducing methane emissions is a particularly effective way to reduce global warming in the short term. The climate impact would be significant and, if extended to other major importers, comparable to the overall effect of recent US climate legislation. However, the impact on energy prices would be small, as abatement costs are low and importers could relatively easily switch to green energy sources. Above all, however, a transatlantic methane agreement would be an important step in kick-starting climate cooperation in other sectors and countries.

A coordinated methane policy would defuse the recent frictions over different policy approaches that have led to a fragile international climate policy architecture.

Against this background, we recommend increased international coordination to reduce GHG emissions. Focusing initially on a small group of willing partners and designing the initial proposals in a way that builds on existing policy developments can significantly increase the incentives for political action. The benefits of increased cooperation on this global collective action problem cannot be overstated.

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