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Policy spillovers in the regulation of multiple pollutants

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Abstract

We analyze the interplay between policies aimed to control transboundary and local pollutants such as greenhouse gases and particulate matter. The two types of pollution interact in the abatement cost function of the polluting firms through economies or diseconomies of scope. They are regulated by distinct entities, potentially with different instruments that are designed according to some specific agenda. We show that the choice of regulatory instrument and the timing of the regulations matter for efficiency. Emissions of the local pollutant are distorted if the regulators anticipate that transboundary pollution will later be regulated through emission caps. The regulation is too stringent with diseconomies of scope, and not enough with economies of scope. In contrast, we obtain efficiency if the transboundary pollutant is regulated by emission taxes or tradable emission permits provided that the revenue from taxing emissions are redistributed to the countries in a lump-sum way and that the initial allocation of tradable emission permits is not linked to abatement costs.

Key Words: environmental regulation, transboundary pollution, multiple-pollutants, co-benefits, ancillary benefits, emission tax, emission standard, tradable emissions permits.

JEL classification: D62, H23, Q50, Q53, Q54, Q58.

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