

We construct a two-country model where pollution from production is transmitted across borders. Pollution abatement is undertaken sequentially by private producers and the public sector. We characterize the Nash optimal levels of the policy instruments in the two countries: emission taxes and funds allocated for public abatement activities. We examine the implications of a number of multilateral policy reforms. One of our findings is that the magnitude of the beneficial effect of a reform depends on the scope of the reform and, if it is restricted to a subset of policy instruments, then the efficiency of environmental policy reform can be greatly undermined.