

Emissions Trading (Cap and Trade)

The Kyoto Protocol, adopted by 170 nations but not the US, established the initial carbon trading market.

The goal of an emissions trading plan is to reduce emissions of greenhouse gases. Typically, a government agency sets an annual limit (**cap**) on the amount of emissions generated. Companies that emit greenhouse gases are given credits or allowances which represent the right to emit a specific amount. The total amount of credits issued cannot exceed the cap, thereby limiting total emissions consistent with a stated goal.

In a **Cap and Trade** system, companies that can reduce emissions will do so and companies that emit greenhouse gases beyond their allowances must buy credits from those who emit less than their allowances or face financial penalties. This transfer of credits is referred to as a **trade**. Theoretically, organizations will choose the least-cost means of compliance, creating incentives that reduce the cost of achieving an emissions limit.

Many sources within the public and private sectors have welcomed emissions trading as the best way to promote emissions reductions. Determining limits and monitoring of actual emissions is required and enforcement of the caps is a challenge, however Cap and Trade emissions trading markets can be easier to enforce because organization by organization regulation is unnecessary.

Critics express doubt that Cap and Trade can work because special interests and lobbyists at work may result in an excess of credits. Once the market becomes aware of a large surplus of credits, the price for credits will collapse without significant reduction of emissions. Cap and Trade critics typically favor regulation as a means to reduce carbon emissions.

Several states have proposed legislation creating Cap and Trade systems with ever declining caps which would alleviate the effects of an overly generous initial credit. Environmental legislation including provisions for Cap and Trade has been introduced in congress recently. It's too early to predict details if successful.