INTERNATIONAL EMISSIONS TRADING

The Kyoto Protocol combines ambitious environmental targets with innovative market-based mechanisms to help Parties achieve those targets at the lowest possible cost. Recognizing that the cost of reducing greenhouse gas emissions is many times greater in some countries than in others, the Protocol allows each country with a binding target (an Annex B country) to use "emissions trading" and other flexibility mechanisms to meet their commitments.

How Emissions Trading Would Work

In an emissions trading system, Annex B countries and their authorized private entities will be able to purchase emissions allowances from each other. Each Annex B country's binding target determines how many allowances it has. Countries may buy or sell these emissions allowances at the government-to-government level. Countries may also authorize their legal entities (companies, individuals, NGOs, etc.) to buy and sell emissions allowances. If the cost of controlling emissions is different in two countries, both will benefit if the one facing lower costs sells some of its emissions allowances to the other. The environmental impact of reducing greenhouse gases will be the same no matter where the reductions take place. Thus, emissions trading will allow the overall reduction required by the Kyoto targets to be achieved at a lower total cost, with both buyers and sellers gaining from the savings allowed by trading.

U.S. Experience with Emissions Trading

U.S. experience with domestic emissions trading has been highly successful. The acid rain provisions of the U.S. Clean Air Act allow electric power plants to trade sulfur dioxide allowances, resulting in an active private market. Emissions are being cut significantly ahead of schedule—over the last three years, emissions have been reduced over 30 percent more than required—and the cost of emissions reductions has been less than 50 percent of what was expected.

Benefits of Trading

In order to provide real environmental benefits, a trading system must have mechanisms for verification, reporting, and accountability that meet high standards. At the same time, the system must be designed to be as efficient as possible to result in cost-effective reductions. Greenhouse gas emissions trading would bring many benefits. It would:

- Promote ratification of and global compliance with the Protocol by making reductions less costly;

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- Provide incentives to reduce emissions below target levels;

- Cut the cost of reducing greenhouse gases by allowing the marketplace to identify the most cost-effective reductions, thereby making efficient use of scarce global resources; and

- Quicken the pace at which countries address climate change by creating a market for innovative ways to reduce emissions cost-effectively and fostering the rapid development and diffusion of new technologies that reduce emissions.

Next Steps

The rules of an emissions trading system need to be clear and predictable—ensuring the integrity of the process while avoiding restrictions that would burden the market or reduce cost savings. To participate in trading, a country must take on a binding target under the Protocol and meet the high standards of the emissions trading system. The U.S. is working with a number of countries to help establish the necessary measurement and reporting capacity.