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Cap-and-Trade's Unlikely Critics: Its Creators

Economists Behind Original Concept Question the System's Large-Scale Usefulness, and Recommend Emissions Taxes Instead

In the 1960s, a University of Wisconsin graduate student named Thomas Crocker came up with a novel solution for environmental problems: cap emissions of pollutants and then let firms trade permits that allow them to pollute within those limits.

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When he was a graduate student in the 1960s working to reduce pollutants, Thomas Crocker devised a cap-and-trade system similar to one being considered in Congress.

Now legislation using cap-and-trade to limit greenhouse gases is working its way through Congress and could become the law of the land. But Mr. Crocker and other pioneers of the concept are doubtful about its chances of success. They aren't abandoning efforts to curb emissions. But they are tiptoeing away from an idea they devised decades ago, doubting it can work on the grand scale now envisioned.

"I'm skeptical that cap-and-trade is the most effective way to go about regulating carbon," says Mr. Crocker, 73 years old, a retired economist in Centennial, Wyo. He says he prefers an outright tax on emissions because it would be easier to enforce and provide needed flexibility to deal with the problem.

The House has passed cap-and-trade legislation. The Senate could take up a measure in September. But Republicans strongly oppose the idea -- arguing that it is a tax that will hurt the economy -- and Democrats are struggling to come up with an approach that apportions the inevitable cost of a cap-and-trade system among different interests, from consumers to utilities to coal plants.

Mr. Crocker, who went on to become a professor at the University of Wyoming, is one of two economists who dreamed up cap-and-trade in the 1960s. The other, John Dales, who died in 2007, was also a skeptic of using the idea to tame global warning.

The Cap-and-Trade Effect

"It isn't a cure-all for everything," Mr. Dales said in an interview in 2001. "There are lots of situations that don't apply."

Mr. Crocker sees two modern-day problems in using a cap-and-trade system to address the global greenhouse-gas issue. The first is that carbon emissions are a global problem with myriad sources. Cap-and-trade, he says, is better suited for discrete, local pollution problems. "It is not clear to me how you would enforce a permit system internationally," he says. "There are no institutions right now that have that power."

Europe has embraced cap-and-trade rules. Emissions initially rose there because industries were given more permits than they needed, and regulators have since tightened the caps. Meanwhile China, India and other developing markets are reluctant to go along, fearing limits would curb their growth. If they don't participate, there is little assurance that global carbon emissions will slow much even if the U.S. goes forward with its own plan. And even if everyone signs up, Mr. Crocker says, it isn't clear the limits will be properly enforced across nations and industries.

The other problem, Mr. Crocker says, is that quantifying the economic damage of climate change -- from floods to failing crops -- is fraught with uncertainty. One estimate puts it at anywhere between 5% and 20% of global gross domestic product. Without knowing how costly climate change is, nobody knows how tight a grip to put on emissions.

In this case, he says Washington needs to come up with an approach that will be flexible and easy to adjust over a long stretch of time as more becomes known about damages from greenhouse-gas emissions. Mr. Crocker says cap-and-trade is better suited for problems where the damages are clear -- like acid rain in the 1990s -- and a hard limit is needed quickly.

"Once a cap is in place," he warns, "it is very difficult to adjust." For example, buyers of emissions permits would see their value reduced if the government decided in the future to loosen the caps.

Joseph Aldy, a White House adviser on the environment, calls the argument a "straw man," saying a market-based cap is being designed with built-in flexibility. For example, a price ceiling on carbon allowances could prevent the program from becoming too big a burden on households and businesses and a floor would prevent a big loss in the value of permits. And unlike a tax, he says, a cap ensures carbon reduction.

Pollution has been a puzzle for economists for decades. In the early 1900s, a British economist named Arthur Pigou proposed taxes on polluters. Ronald Coase, a University of Chicago economist, won a Nobel Prize for his 1960 book, "The Problem of Social Cost," which showed how market economics could address pollution problems.

In 1966, Mr. Crocker, still struggling to finish his thesis at the University of Wisconsin at Milwaukee, sketched out the cap-and-trade idea to deal with air pollution produced by fertilizer plants in Florida. Mr. Crocker first pitched the idea of trading at a conference in Washington. He had been asked to attend as a stand-in for a professor who couldn't go and present data on the Florida plants. He didn't

have all the data yet and came up with the theory instead.

Working separately, Mr. Dales in 1968 published a book called, "Pollution, Property and Prices," which used the same approach for farmers who were polluting Canadian lakes and streams.

Their logic went like this: When governments capped smog emissions from power plants or the runoff of pesticides by farmers into local streams, it was indirectly putting a value on these emissions. Some farmers and some power plants could reduce these emissions more efficiently than others, and some placed a higher value on them than others. By setting caps on pollution but then allowing the polluters to trade these rights, the economists theorized, the polluters themselves would figure out the cheapest way to meet new targets.

Another economist, David Montgomery, advanced their ideas in the 1970s, converting their theories into the complex mathematical formulas to demonstrate that they weren't merely an idea but were also economically feasible. Mr. Montgomery, too, is a skeptic of cap-and-trade for greenhouse gases. He prefers an outright tax.

"You get huge swings in carbon prices with a cap, which creates more volatility and uncertainty for business," he says.

Cap-and-trade got a big boost in 1990, when President George H.W. Bush signed amendments to the Clean Air Act that imposed new limits on emissions of sulfur dioxide, which produces acid rain. Economists said the move let producers save billions of dollars and still hit their targets.

Still, Messrs. Dales and Crocker never got much personal mileage out of the idea. Mr. Crocker says he had such a hard time getting funding to further his research on the subject that he moved on to other matters. So far, he has stayed on the sidelines in the debate about cap-and-trade.

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