

## Cap and Trade Trap

Despite the coldest and snowiest Midwest winter in decades, global warming has taken over the Congressional calendar. This week Congress will vote on a bill that is designed to regulate so-called “greenhouse” gas emissions through something called a “cap and trade” system. Not since rationing in World War II, has the US contemplated such a draconian interference in the economy. While cap and trade is unlikely to pass this year, every major presidential candidate supports the approach. In other words, it will be back.

The bill, which is named “America’s Climate Security Act,” would actually set up two cap and trade systems – one for most types of “greenhouse” gases (mainly carbon dioxide) and another for hydro-fluorocarbons.

Under these systems, the federal government would set a maximum limit on the emission of certain gasses. This is the “cap.” Under this cap it would sell or give-away permits to companies, state/local governments, and other organizations. Permit owners would have the right to use the permits or “trade” them at market prices, like any other commodity.

The ability to trade the permits is why some see the bill as a “market-based” approach to reducing emissions. Compared to direct regulation – where the government simply bans certain types of production methods in order to hit a maximum emissions target – a cap and trade system would certainly be less costly. Trading would allow the permits to gravitate toward firms that can generate the highest profits per unit of emissions.

Nonetheless, the legislation being debated by Congress right now would make a Soviet Central Planner feel right at home. The premise of the plan is that the government knows the right level of emissions. But this is absurd. No one person, or group of people, knows the “correct” level of CO<sub>2</sub> emissions, any better than the old Soviet Union knew the “right” number of TVs or cars its subjects wanted.

One interesting twist is that the most prominent legislation being debated gives away allowances to existing companies for a portion (maybe 60%) of their current emissions. Companies must then purchase permits for emissions above and beyond the allowances. These allowances are worth trillions of dollars over the next 40 years, and the government seems to be using them to help curb dissent against cap and trade. In other words, there is a huge incentive for political corruption. Only existing companies will benefit from these allowances. New companies will be at a distinct disadvantage.

Over the next 40 years or so, the allowances for CO<sub>2</sub> emissions will decline, and the restrictions will get tighter. Not only will the Federal government reap trillions in added revenue, but this cost will be shifted onto the consumer. While no one knows the future with any certainty, without a major breakthrough in energy technology, consumers will experience a massive increase in the cost of energy under “cap and trade.” As a result, any legislation will lead to “off-shoring” of emissions, a loss of US competitiveness, higher production costs, and much slower economic growth.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-2 / 9:00 am	ISM Index – May	48.5	<b>48.0</b>		48.6
9:00 am	Construction Spending – Apr	-0.6%	<b>-0.7%</b>		-1.1%
6-3 / 9:00 am	Factory Orders – Apr	0.1%	<b>-0.4%</b>		1.3%
<i>sometime</i>	Domestic Auto Sales – May	4.9 Mil	<b>5.0 Mil</b>		4.7 Mil
<i>during the day</i>	Domestic Truck Sales – May	5.9 Mil	<b>6.0 Mil</b>		5.9 Mil
6-4 / 7:30 am	Q1 Non-Farm Productivity	+2.5%	<b>+2.5%</b>		+2.2%
7:30 am	Q1 Unit Labor Costs	+1.9%	<b>+1.9%</b>		+2.2%
9:00 am	ISM Non-Man. – May	51.0	<b>52.0</b>		52.0
6-5 / 7:30 am	Initial Claims – May 31	370K	<b>373K</b>		372K
6-6 / 7:30 am	Non-Farm Payrolls – May	-50K	<b>-95K</b>		-20K
7:30 am	Unemployment Rate – May	5.1%	<b>5.1%</b>		5.0%
7:30 am	Average Hourly Earnings	+0.3%	<b>+0.4%</b>		+0.1%
7:30 am	Average Weekly Hours – May	33.7	<b>33.7</b>		33.7
7:30 am	Manufacturing Payrolls – May	-27K	<b>-52K</b>		-46K
2:00 pm	Consumer Credit – May	\$6.8 Bil	<b>\$7.7 Bil</b>		\$15.3 Bil