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CAP AND TRADE 101

The regulatory options for the reduction of greenhouse gases are myriad and often confusing. Until recently our actions in the U.S. have largely been voluntary, an approach now widely acknowledged as inadequate. This is changing. Over the last few years, over 20 states have adopted carbon reduction goals and are now in the process of developing regulations to meet those goals. Just this year, the Climate Security Act was introduced into the U.S. Senate, the most significant attempt yet to mandate national action on global warming.

Several states have also joined together to create regional agreements to reduce greenhouse gases, including the Regional Greenhouse Gas Initiative (RGGI) and the Western Climate Initiative (WCI). The centerpiece of both initiatives is a carbon cap and trade system, a concept that first gained traction in the European Union and is now viewed as the primary and most viable means for near-term carbon reduction.

What is cap and trade exactly? Very simply, a regulating body places a cap on the amount of emissions that a group of polluters is allowed to emit. The cap is set lower than current emissions and gradually ratcheted down over time. The total amount of emissions permitted under the cap is divided into allowances, say one ton of pollution equals one allowance. These allowances are allocated to polluters who are then free to buy or sell them, while staying within the limits of the cap. Polluters who are able to reduce their emissions at low cost can sell their extra allowances to polluters who face higher costs.

The advantage of a cap and trade system is that it utilizes the power of the marketplace to achieve the cheapest, most efficient emissions reductions first. It gives polluters clear goals, a predictable timeline and flexibility, and allows our economy time to adjust.

PRINCIPLES FOR AN EFFECTIVE CAP AND TRADE SYSTEM

In order to be most effective, a cap and trade system should generally adhere to a set of basic principles to ensure its effectiveness in reducing greenhouse gas emissions. The cap should be comprehensive and cover all major sources of global warming pollution. Revenue generated within the system should benefit the public, including making investments that will help spur new economic development, provide assistance for low-income families and help protect natural resources threatened by the impacts of global warming. And in order to achieve the WCI interim goal of 15% below 2005 levels, a cap

and trade system should be implemented no later than 2010. Reductions should begin before 2012.

What follows is a primer on the main points of decision that Oregon and the other WCI states must address in developing the trading program. Included are the key policies that OEC believes should be incorporated in the final design of the regional system.

Program Scope

The **program scope** refers to the extent to which a cap and trade system covers different economic sectors. For example, the RGGI is limited in scope as it covers only the electricity sector and does not include other areas that are responsible for large amounts of greenhouse gas emissions, such as transportation.

OEC believes that the cap and trade system should be applied to as many sectors of the economy as is practical and feasible. This includes electricity, commercial and home heating fuels, transportation fuels and oil and gas extraction and production. Creating a broad, common market for emissions will help ensure that energy costs stay consistent and protect against price spikes, as well improve efficiency, flexibility and overall effectiveness within the system.

Point of Regulation

The **point of regulation** for a cap-and-trade system refers to the point at which emissions fall under the jurisdiction of participating entities.

OEC believes that in order to be effective, a regional cap and trade system should account for emissions that are generated within the Western states and those emissions that are imported from outside the region. This means that any entity responsible for importing power from out of state, or generating power within the state, will be included within the cap. For example, if a utility in Oregon imports power from a company that owns a coal plant in Wyoming, the Oregon utility would be responsible for the emissions associated with the purchase of the coal-fired electricity.

This method of regulation is also known as “first jurisdictional deliverer” and is currently the approach favored by the WCI states.

Apportioning Allowances

Once a regional cap is set, **allowances** – also referred to as pollution credits – must be **apportioned** or divided between jurisdictions (states or provinces). How many allowances each jurisdiction ends up with depends on how much global warming pollution the state is responsible for and to what degree a state has already implemented other greenhouse gas reduction measures. Each jurisdiction is then responsible for further allocating allowances to specific sectors or polluters.

Since the WCI has set a regional goal of reducing emissions to 15% below 2005 levels by 2020, OEC believes that to be fair each sector included under the cap should reduce its

own emissions accordingly. In other words, each sector must reduce its emissions by 15% below 2005 levels.

Polluters may acquire the allowances they need in order to continue emitting greenhouse gases by either of two methods. The first method is free distribution of allowances from the state to an emitter. The second is by auction, or sale, of credits from the state to the polluting entity.

OEC believes that carbon allowances should be considered a public asset; therefore, the value of the allowances should be used for the public benefit. Allowances should be auctioned and the revenues should be used to further reduce carbon or otherwise benefit the public. Examples of programs that benefit the public include energy efficiency and renewable energy development, assistance to low-income energy consumers, assistance and training (particularly in the clean energy sector) for dislocated workers, and adaptation measures for global warming impacts to natural resources.

Offsets

An **offset** is generated by the avoidance, reduction or sequestration of greenhouse gas emissions from a specific project and is used to counteract the emissions released from another source. In order to determine how effective an offset is, a baseline estimate of likely emissions associated with the project must be made, along with a baseline estimate of how much will be avoided with the offset. The difference between the two is the actual GHG benefit.

OEC believes the use of offsets in a regulatory regime should be limited. While offsets can be a valuable tool and can help spur innovation in energy efficiency and renewable energy, there are often associated questions of environmental integrity, quality and authenticity. As well, we would prefer that offsets be limited to projects in the WCI region. This would help retain some of the co-benefits offset projects, such as job creation and diminished pollution.