

# Cap and Trade

Cap and trade is a policy tool to reduce greenhouse gas emissions. It includes four main elements: a cap, allowances, a trading system and offsets.

## Cap

A cap commits a region or country to specific limits on emissions and then reduces those limits over time. The cap is normally set as a percentage reduction below a prior year's emissions level. For example: 3 percent reduction below 2005 levels by 2012.

## Allowances

The emissions cap is divided into allowances. Typically, one emission allowance equals the authority to emit one (metric) ton of carbon dioxide-equivalent. A metric ton is equal to 2,200 pounds.

## Trade

Trade means entities may buy, sell or trade allowances between themselves or others. This creates a market for allowances. A trading system places a market price on allowances.

## Offsets

An offset is an activity other than a direct emission reduction that can be done to lower emissions. An offset must be for an approved, measurable activity that reduces, avoids, or sequesters emissions from a source not covered by an emission reduction program. Examples: planting trees, paying dairy farmers for methane capture systems, paying farmers for reduced or no-till activities.

## How does cap and trade work?

- Tally emission levels – this is done by the Energy Information Administration and Environmental Protection Agency (EPA).

- Set a cap – 2005 has been selected as the base year for current proposed legislation; emission cap would begin in 2012 as a small percentage below 2005 levels.
- Distribute allowances – a percentage are given out freely while some will need to be purchased or traded. EPA would regulate this with severe penalties for non-compliance.
- Step it down – the cap would decrease each year to reach an 80-90 percent decrease from 2005 levels by 2050.

## Important elements to remember

- Emissions sources subject to the cap and trade system are called covered sources. They include power plants and carbon-intensive industries, fuel producers/processors (petroleum refineries or natural gas distribution), or some combinations of both.
- Emissions sources, such as agriculture, may not be covered in a cap and trade system under proposed legislation. If agriculture were covered, it could not be used as an offset.
- The use of offsets is typically limited for covered sources to about 30 percent of their total reduction requirement.
- Carbon capture technology to reduce emissions from major emitting sources, like power plants, is not commercially available today.
- Cap and trade is market-based, so there's no price certainty. The market decides what the trading price of emissions will be at any given time.
- If a cap and trade system is not structured properly, any business or organization can buy up allowances and either hold onto them or retire them, artificially lowering the cap.
- Under a cap and trade system, each industry is given flexibility on how to reduce emissions.