Cap and Trade 101:
Sightline's Climate Policy Primer in 2 Pages

In the coming months, climate policy will be written by each state and province participating in the Western Climate Initiative, the biggest cap-and-trade system proposed in North America. All cap-and-trade systems are not equal, however. They can be graded on a few basic principles that ensure maximum effectiveness and protection for families. Sightline Institute's policy analysis is laid out in full in "Cap and Trade 101: A Climate Policy Primer." Here, in 2 pages, are the key questions that every consumer and lawmaker should ask as policy is developed for their jurisdiction.

WHAT IS CAP AND TRADE?

Cap and trade commits a region to responsible limits on global warming emissions and gradually steps down those limits over time. Setting commonsense rules, cap and trade sparks the competitiveness and ingenuity of the marketplace to reduce emissions as smoothly, efficiently, and cost-effectively as possible.

In short, the "cap" is a legal limit on the quantity of greenhouse gases that a region can emit each year and "trade" means that companies may swap among themselves the permission – or permits – to emit greenhouse gases.

WHAT CAP-AND-TRADE DESIGN WORKS BEST?

Cap and trade is a tested and proven system for reducing pollution. But for maximum effectiveness, efficiency, and fairness for consumers, it requires four basic characteristics:

1) *It is **comprehensive** in scope.* Excluding any major sector (such as transportation fuels, the Northwest's largest source of greenhouse gases) would make the cap vastly less effective and put an undue burden on the sources that are included.

2) *Its point of regulation is **upstream**.* The system operates where fossil fuels enter the economy. By far the simplest point for measurement, upstream regulation means that fewer than one-tenth of one percent of businesses have any direct interaction with the system

3) *Its permits are allocated by **auction.*** To prevent unfair windfall profits for big energy companies *at the expense of consumers,* pollution permits should be sold at public auctions, not given away for free to polluters. Proceeds can be invested in local communities and families. Auctioning also helps protect against market manipulation and "gaming."

4) *It uses auction revenues to **protect in-state families**.* Revenue from permits should go, first and foremost, to ease the transition to a new energy economy. Revenues can also be invested in community benefits like job training, energy efficiency, and renewable energy production, putting the state at a competitive advantage in a growing clean-energy economy.

WHY NOT GIVE AWAY PERMITS?

Put simply, giving away free permits is the worst program design for consumers. Cap and trade puts the same price on climate pollution whether the permits are given away or auctioned. The only difference—an extraordinarily important one—*is who gets the extra money that consumers are paying for energy*: fossil-fuel companies or in-state families and communities?

Giving away permits is just like handing out money, taking billions of dollars out of the pockets of energy consumers and handing them to energy companies.

More about climate policy and fairness
The transition to a clean-energy economy will bring both opportunities and challenges for all of us, but may be especially hard on low-income families:

- Some climate change is already unavoidable; low-income families, especially in rural areas, are most vulnerable to its effects: floods, droughts, and extreme storms.
- High energy prices hit low-income families hardest. In 2005, when energy prices were low, the poorest families in the US devoted almost 15 percent of their household budgets to residential energy—more than *four times* as much as better-off families.

Fair climate policy should protect in-state families. **We can all share the burdens and benefits of building a new, clean energy economy.**

HOW SHOULD WE INVEST AUCTION REVENUE?

If carbon allowances are auctioned rather than allocated for free, the resulting revenue could be substantial for the Northwest jurisdictions on British Columbia, Oregon, and Washington.

What should we do with the money? A comprehensive cap-and-trade system *guarantees* declining emissions—it is, by itself, a complete strategy for reducing greenhouse gases. That means auction revenues can be used to ensure fairness for low-income families; to stimulate in-state, green-collar jobs; and to position Northwest states as leaders in clean-energy technology.

Here are several leading options for investing auction revenues in concrete benefits for the families and communities of WCI states and provinces.

Option 1: Dividends for all. Rebate all auction revenue to state residents on an equal per-person basis. Everyone pays more for energy; but everyone gets a dividend check. The net effect would be to benefit low- and middle-income families.

Option 2: Rebates for low-income families. Pay dividends only to families with very low incomes to buffer them from cost increases. This option matches funds neatly to needs, and leaves a significant portion of auction revenue available for other uses.

Option 3: Help Northwest families save energy. Invest auction proceeds in energy efficiency to benefit families—weatherizing homes, for example. This lowers energy bills and emissions, and generates hundreds of green-collar jobs.

Option 4: Job training. Spend a portion of auction revenue training a green-collar workforce.

Option 5: Investment in communities. Several other uses for revenue from carbon-permit auctions: research and development for new clean-energy technology; programs to reduce emissions from hard-to-cap sectors such as forests and farms; and infrastructure, such as transit services and retrofits for public buildings and vehicle fleets.

FURTHER INFORMATION

For more in-depth information, analysis, and data sources on the topics discussed here, please see Sightline Institute's paper "Cap and Trade 101: A Climate Policy Primer" (September 2008). And see *www.sightline.org/climate* for Sightline's most recent work on fair, effective climate policy.