

A Firm Cap and a Stringent Emissions Reduction Timetable Are Critical for an Effective United States Cap-and-Trade Program

Aggressive near-term action is essential to stabilize the global climate.

The United States must cap its greenhouse gas emissions at current levels and steadily reduce the cap to at least 25 percent below 1990 levels by 2020 and to 80-95 percent below 1990 levels by 2050. A firm cap with steadily declining reduction targets will (1) help limit future warming, (2) promote long-term planning and investment in low-carbon technologies, (3) encourage strong action by other nations, and (4) facilitate steeper cuts in future years if called for by new scientific information.

Key elements in designing an effective cap-and-trade program —

- **Scope.** A comprehensive, economy-wide cap-and-trade program covering all greenhouse gases and all major sectors and emissions sources will increase certainty that critical emissions reduction targets are met. Complementary policies such as stronger energy efficiency standards, renewable energy standards and higher fuel economy standards will also be needed, but they are not a substitute for an effective cap on emissions.
- **Allocation.** Allowances should be auctioned rather than distributed free, with revenues used in the public interest, e.g., to fund efficiency measures and clean-energy technologies, invest in green-jobs training programs, cushion vulnerable households from higher energy prices, and help communities adapt to the unavoidable impacts of global warming.
- **Banking.** Allowing capped entities to hold unneeded allowances for use in future years will create incentives to make larger emissions reductions in the near term. Early action is especially important because a significant fraction of carbon dioxide remains in the atmosphere for thousands of years, making it all the more critical to limit cumulative emissions.
- **Borrowing.** Allowing firms to use future-year allowances to satisfy current-year obligations should be strictly limited. Regulations concerning the amount that can be borrowed, the repayment period, and the rate of interest should be designed to ensure that cumulative emissions targets are met.
- **Offsets.** Firms should be permitted to use offset credits generated by projects outside the cap-and-trade program to satisfy a small fraction of their compliance obligations. An offset program can help address emissions in sectors that don't lend themselves to a trading system, e.g., agriculture, landfills, and forestry, as well as support qualified projects in developing countries.

The quantity of offsets must be limited, however, so as to maintain incentives for capped entities to invest in new technologies. Offset projects must meet rigorous standards to ensure their environmental integrity and that they achieve real, permanent reductions that go beyond what would have occurred without the incentive of the offset.

The following mechanisms would undermine the integrity of the emissions cap and should be rejected.

- **Safety valve.** Setting a ceiling on the price of allowances and permitting capped entities to purchase unlimited additional allowances once that ceiling price has been reached would slow emissions reductions and erode incentives for investments in new technologies. It would also hinder linkage with international carbon markets, which do not use safety valve mechanisms.
- **Circuit breaker.** The option of delaying the scheduled timeline for emissions reductions if the price of allowances rises above a specified level would jeopardize the environmental certainty of the cap.