The Canadian government is moving ahead with its design of a national emissions trading scheme – but against an increasingly uncertain policy backdrop. JOHN DREXHAGE reviews progress so far

Still up in the air

Although Canada has ratified the Kyoto Protocol, there remains a considerable amount of work to be done before the country will be able to meet its Kyoto commitment to reduce its greenhouse gas (GHG) emissions by 6% from 1990 levels by 2008–12. That's not to say no progress has been made – there has, particularly in the development of a national emissions trading and covenant system for large GHG emitters. However, the policy signals, both on the international and national front, have become decidedly less clear.

First, there is no doubt that the question of Russian ratification is beginning to place a seed of doubt in Canada as to whether the Protocol will ever come into force and, if it does not, how Canada will respond. Environment Minister David Anderson stated, as recently as October of last year at a climate change conference in Moscow, that Canada will meet its Kyoto commitments in the absence of the Protocol coming into force.

But there are some serious questions as to how Canada would meet its target affordably if it did not have access to Russia's surplus emission units. Further, if the Kyoto Protocol were not to enter into force, what would be the legal basis for Canada purchasing emission credits from abroad to meet its Kyoto target?

Canada has also continued to seek to gain credit for emission reductions through 'cleaner energy exports' of natural gas and hydro power, essentially to the US. However, while Canada was successful in keeping the issue on the international agenda at COP 9 in Milan last December, it is also clear that the vast majority of countries strongly oppose any such exemption provision for Canada.

On the domestic front, Paul Martin became Canada's new prime minister in December, replacing his Liberal Party colleague Jean Chrétien. While he voted in support of ratification when it was brought before Parliament in December 2002, he also expressed concerns about the consultation process leading up to ratification and said that the government of his predecessor had not laid out a clear plan on how Canada would actually meet its commitments.

Martin has been pressured by the media and his political opponents on this issue since he became leader but his party's website states he "remains committed to the Kyoto Protocol. In fact, he has stated that Canada's commitment to address the causes of climate change will proceed regardless of the status of Kyoto." But this clearly begs the question, does that mean meeting the Kyoto commitments, or some other form of commitment that could also be understood as addressing the causes of climate change?

> **Senior officials expect the government to proceed with emissions trading legislation that could come before Parliament this fall**

What makes this question that much more pertinent are a number of related matters. Primary among these is the assertion by the new prime minister that his priorities will lie in improving relations with both Canada's provinces and the US. In regard to the provinces, Martin is keen for his Liberal Party to improve its support in the west, particularly Alberta and British Colombia (BC), where the Kyoto Protocol is either explicitly (Alberta) or implicitly (BC) opposed. It is also widely known that his two most senior MPs in the cabinet, Ralph Goodale of Saskatchewan and Anne McClellan of Alberta, have strong concerns about Kyoto and its implications for the powerful fossil fuel energy industry in Canada.

The US represents another set of challenges for the prime minister. Given the sensitivities that already exist on mad cow disease, SARS and cross-border security issues, not to mention the plethora of outstanding trade issues, would Martin want Kyoto to present yet another irritant, given the current Bush administration's opposition to almost anything related to climate change? That said, the option of a regional agreement with the US looks even more remote than Kyoto – it is clear that there is no willing dance partner in the present administration in Washington DC to any serious policy interventions to reverse GHG emission trends.

Emissions growth

But the real kicker comes in when one examines what Canada has actually accomplished in reversing its emission trends since 1990 (see figure). The latest inventories indicate that Canada's emissions grew some 20% between 1990 and 2000, while US emissions grew by only 14% during the same time – this despite the fact that the US economy grew more quickly than Canada's. The current 'gap' between meeting the Kyoto target and 'business-as-usual' (BAU) projections is officially set at 240 million tonnes of carbon dioxide equivalent ($MtCO_2e$) each year over Kyoto's first compliance period, but the word in the corridors around Ottawa is that it may actually be as high as 280 Mt.

But perhaps we are too hasty in drawing any conclusions just yet. First, it is highly doubtful that the prime minister will want to distance his government from Kyoto too early with a general election almost certain to occur sometime later in the spring. Public support for the Protocol remains strong, especially in central Canada, and Martin himself has consistently and publicly expressed strong allegiance to multilateralism and international co-operation.

In addition, the federal government has put up some real money towards meeting its Kyoto commitments. In addition to the C$1.7 billion ($1.3 billion) provided for in Canada's Action Plan 2000 on climate change, a further C$2.0 billion was identified in last year's budget, covering five years. A significant portion of the budget (some C$1.3 billion) has already been allocated.

One of the more interesting parts of the Canadian plan is the government's decision to seek an annual 55 Mt of reductions from the Large Final Emitters Group (LFEG). Established in late 2002, under the Natural Resources Canada ministry, the government decided to set up a national covenant-emissions trading system for its largest emitters in the fossil fuel, utility, mining and manufacturing sectors.

The price for getting industry on side with this initiative was regarded by many, particularly within the environmental community, as too high: industry was assured that they would not have to pay more than C$15 per tonne of CO_2 to meet their commitments and that the specific targets would be intensity-based – on average a 15% per unit improvement from its projected BAU performance in 2010.

In addition, the government of Canada assured industry that if the 15% intensity mark was met and it still did not deliver the expected 55 Mt, the government would be responsible for filling the remaining gap. How it would do so has never been elaborated, but one supposes through purchases in the international carbon market.

Essentially, the government made a political decision that, at least for the 2008–12 period, the emissions trading system should focus on ensuring that industries be protected from competitiveness concerns arising out of the US decision not to ratify Kyoto. There were many other stakeholders in Canadian society – ranging from the environmental community to provinces with strong clean energy opportunities and even significant labour interests – who had hoped that the emissions trading system would send strong signals that the Canadian economy was embarking on a real transition towards a low-carbon future. But those under threat (perceived or otherwise) clearly held sway.

Nevertheless, it cannot be denied that significant progress has been made in implementing the LFEG plan. The feedback from most in industry is that both the tone and substance of discussions with the government have appreciably improved since it began negotiations with industry – as is evident from agreements recently signed with the Forestry Products Association of Canada and DuPont Canada (see *Carbon Finance*, December 2003, page 9). In addition, and despite the policy uncertainty currently reigning in Ottawa with the leadership transition, senior officials expect the government to proceed with emissions trading legislation that could come before Parliament this fall.

The legislation, which is unlikely to take effect before the spring of 2005, will include provisions to:

- ☐ prohibit industry emitting CO_2 without permits;
- ☐ quantify emission covenants with the different sectors;
- ☐ lay out the rules for emissions reporting;
- ☐ set schedules and regulations for actions by the affected sectors; and
- ☐ define the intensity levels expected.

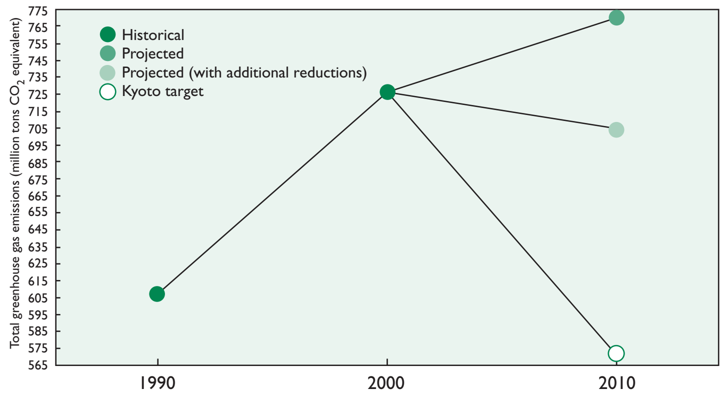
Specific regulations and intensity levels will be open to change through discrete covenant agreements, which would work to recognise the particular circumstances of companies that have taken early action, have unique competitiveness considerations to take into account or are able to demonstrate a significant discontinuity in their emissions intensities.

In addition, the government is committed to providing industry with the opportunities to use both domestic and international credit-based investments, or offsets, to help it meet its targets.

There is a strong sense that, notwithstanding the government's eventual decision on Kyoto, Canada will in the next few years have a national carbon management system for its largest industrial emitters in place. The fact that the government recently signed an agreement with the Canadian Working Group on the Carbon Market, a group comprising a broad range of organisations in Canada, is a demonstration of that development. The agreement establishes a set of principles for the design and functioning of a market for GHG emission compliance instruments in Canada, and recognises that it brings Canada one step closer to developing such a market.

Despite progress in this important area, the rest of the plan, as Martin has already stated, is seriously lacking in definition in virtually every area, particularly in targeted measures. Even if we

Canada's greenhouse gas emissions



Source: FCCC-SBI-2003-7-Add 3, Table 4. GHG projections for Annex I Parties.
Actual and projected emissions of six greenhouse gases (CO_2, CH_4, N_20, HFCs, PFCs, SF_6).
Land use change and forestry not available.

were to accept the government's calculations (and the vast majority of stakeholders in industry and the environmental community do not) the current plan only closes the gap to around 174 Mt, leaving a shortfall of at least 66 Mt.

This means that international purchases will be an important component if Canada is to reach its Kyoto target. But such purchases are regarded with scepticism by the Martin administration, a view shared by many (though by no means all) both within industry and the environmental community. There is a concern prevalent in industry that the rules for credit-based purchases, through the Clean Development Mechanism (CDM), appear to be too costly and purchases of surplus emission units from Russian and other Eastern European countries represent to many a simple wealth transfer without any tangible environmental benefit.

Opportunities

There are solutions – there is still the opportunity to have a CDM and Joint Implementation regime in place that will not result in high transaction costs, and the Canadian government has been pursuing bilateral negotiations with economies-in-transition whereby purchases through emissions trading could be used to tangibly benefit both Canadian clean technology exports and the environment – but much work remains to be done.

However, what is most lacking is a clear sense of direction and co-ordination from the new government. The first thing Martin needs to do, and sooner rather than later, is to establish a policy management mechanism from the centre of his government that gives clear signals to other departments on the direction the government will be headed. Despite the PM's continued allegiance to Kyoto, there are many bureaucrats who are still not committed to this policy goal.

Secondly, there needs to be a much more transparent and credible consultation process. The body that served that purpose – the Climate Change Secretariat – is being disbanded, and nothing as of yet is taking its place. All stakeholders need to be engaged – and when we are talking about the overall intent and implementation of the plan this should involve stakeholders meeting and discussing these issues together and not separately.

So what to conclude? This is definitely a work in progress, and time is getting short. Before all the necessary legislation and regulations are in, 2008 will be just around the corner, if not already past. But of one thing there can be no doubt – Canada is definitely on the path towards carbon emissions management in one form or another. And perhaps we should not overlook the significance of that accomplishment in and of itself. ***CF***

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