



Cap and Trade Policy Design: Key Issues

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A Changing Policy Context

- Despite the economic downturn, the U.S. is about to start taking serious action on greenhouse gases
 - In fact, the U.S. plans to put green innovation at the heart of its economic recovery
- Canada wants a North American approach
- Our assessment is that linking to U.S. cap and trade will mean significantly strengthening Canada's system...
- ...which means that many aspects of "Turning the Corner" are now "off the table"

Linking with the U.S. Means...

- An absolute cap, not intensity targets
- Simpler compliance options: technology funds, pre-certified credits and early action credits will be very difficult to maintain
- Instead, the government can support technology development and reward early action through auctioning and the use of auction revenues
- Canada leading, not just following: treat U.S. cap and trade as a minimum, not a maximum

Getting to a North American Cap and Trade System: Key Design Questions

- Emitters are required to hold an allowance for every tonne they emit
 - Coverage: which sectors are included?
- Government issues a fixed number of allowances, which make up the cap and can be freely traded
 - Cap level and timing: how many allowances are issued in which years?
 - Allowance allocation: give away for free or auction off?
- Offset credits can be issued for emission reductions outside the cap and used for compliance
 - Limits on offsets: are they allowed, and if so, from what sources (domestic/international) and up to what amount?

Design Principles

- Environmental Effectiveness
- Economic Efficiency
- Administrative Simplicity
- Political Feasibility
 - Especially equity among individuals, sectors and regions

The Case for Broad Coverage

- Heavy industry plus fuel use in transportation and buildings (covering over 80% of Canada's emissions):
 - Aligns with U.S. proposals
 - Is administratively straightforward
 - Increases equity between sectors
 - Maximizes economic efficiency

The Case for 100% Auctioning

- Avoids complexity and lengthy delays
- Prevents windfall profits
- Automatically rewards early action
- Generates revenues that can be dedicated to:
 - Targeted protection of industrial competitiveness
 - Protecting low-income Canadians
 - Ensuring regional fairness
 - Supporting green technology
 - Supporting climate adaptation and emission reductions in developing countries
 - Tax cuts

The Case for Limits on Offsets

- WCI, the leading U.S. federal bill, the EU and Australia all have limits
- Rigorous offsets require a huge administrative effort
- Even with strict rules, many offsets can be “fraudulent,” undermining public credibility
- There is little “space” to create credible offsets if the cap and trade system is broad-based
- The government can provide separate incentives for reductions in non-covered sectors

The Case for a Stronger Cap

- A simple and equitable approach to setting the cap is to require the covered sectors to do their proportional share of the national target
- Any credible cap will result in large-scale deployment of CCS as soon as possible
 - CCS is only economical at well over \$50/tonne (\$3–5/barrel for oil sands producers)
- A science-based national target for Canada would mean a cap that produces an emissions price of about \$200/tonne CO₂e in 2020

The Case for Starting in 2010

- Gives Canada greater influence in negotiations with Washington: “policy maker”
- Increases certainty for business, leading to more green investment and innovation in the near term
- “Pilot phase” allows Canada to refine policies and prepares industry before linking with U.S.
- Increases credibility in global climate negotiations

Other Issues for Discussion

- Interaction with provincial regimes
- Emissions pricing during a recession
- Process and timeline for moving to a new regulatory proposal

Conclusion

The new policy landscape gives Canada an unprecedented, but time-limited, opportunity to show environmental leadership.