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Recommendations for Manitoba's Proposed Cap and Trade System

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Overview

The Pembina Institute appreciates the opportunity to comment on Manitoba's proposed cap-and-trade system. We encourage the province to move quickly in establishing a system that is effective, comprehensive, fair and transparent. Doing so will allow Manitoba to decrease greenhouse gas pollution and increase investment in clean energy solutions.

Implementing a cap-and-trade system with other Western Climate Initiative (WCI) partners offers two additional advantages:

- Manitoba can help kick start a broader effort to reduce greenhouse gas pollution. For example, a cap-and-trade system comprised of B.C., Manitoba, Ontario, Quebec, California and New Mexico would apply a carbon price to economies that are responsible for 913 million tonnes of greenhouse gas pollution (24% more than Canada's).
- Manitoba can help increase the market demand for clean energy and energy efficiency solutions that Manitoba businesses will be able to compete for. The same system comprised of B.C., Manitoba, Ontario, Quebec, California and New Mexico have a combined GDP of \$3 trillion (almost 20% of the total from Canada and the U.S.).

The degree to which those benefits are realized depends in large part on the rules of the cap-and-trade system. That's why this consultation, and the details of the eventual system, are so important. If the rules effectively create an increasing incentive to reduce pollution and invest in clean energy solutions, the benefits will be considerable. If the rules fail to do this, the system will fall short of expectations.

Manitoba's cap-and-trade system should be:

- **Effective** in that it provides an adequate incentive to invest in clean energy.
- **Comprehensive** in that it applies to all sources of accurately measurable emissions.
- **Fair** in that it ensures households, communities and businesses throughout the province are treated equitably and given an opportunity to be part of the solution.
- **Transparent** in that the public and Manitoba businesses will have confidence that the approach is going to be effective, comprehensive and fair.

Recommendations

We offer the following five recommendations:

Recommendation	Recommendation helps the system be:			
	More effective	More comprehensive	Fairer	More transparent
Implement the cap-and-trade system by January 2012	✓		✓	
Set a cap that aligns with short- and medium-term reduction targets	✓			
Include all sources of accurately measurable emissions	✓	✓	✓	
Distribute all allowances by auction			✓	✓
Eliminate or reduce reliance on offsets	✓		✓	✓

1. Implement the cap-and-trade system by January 2012

We recommend that Manitoba move quickly to implement its proposed cap-and-trade system so that the province is ready to join other WCI partners in January 2012. Doing so would help Manitoba start reducing greenhouse gas pollution and provide a momentum boost to the entire WCI cap-and-trade system. The fact that three other provinces (Quebec, Ontario and B.C.) have invested significant effort into designing the regulations needed to make cap-and-trade work in provincial contexts makes this timeline possible in Manitoba.

There is ample evidence in support of an expedited implementation timeline:

- A recent report from the National Round Table on Environment and Economy recommended that Canada should implement a cap-and-trade system without waiting for the United States.¹ They argued that such an approach would allow Canada to pursue its climate change objectives while protecting the country's economy, provided that the carbon price the system produces doesn't get too far in front of any U.S. approach.²
- Various other studies have show that carbon pricing can increase the international competitiveness of many sectors of the Canadian economy if revenues are used to reduce taxes that discourage economically desirable activities (e.g. income taxes).³

¹ Parallel Paths: Canada-U.S. Climate Policy Choices (2010). Accessed on March 15, 2011 at <http://www.climateprosperity.ca/eng/studies/canada-us/report/canada-us-report-eng.pdf>.

² The report recommended keeping Canadian carbon prices within \$30 per tonne of U.S. prices.

³ See "Pricing Greenhouse Gas Emissions: The Impact on Canada's Competitiveness" (Chris Bataille et. al., 2009) and "Impacts of climate policy on the competitiveness of Canadian industry: How big and how to mitigate?" (Nic Rivers, 2010).

2. Set a cap that aligns with short- and medium-term reduction targets

In general, the cap in Manitoba's cap-and-trade system should be set in a way that allows Manitoba to achieve its province-wide emissions reduction targets. Manitoba's only current target is for 6% below 1990 levels by the end of 2012, and this would provide a sensible starting point for the 2012 cap.⁴ The cap for subsequent years should steadily decline to provide an increasing incentive to invest in clean energy solutions. In the absence of a specific medium-term target (e.g. 2020), the rate of decline of the cap should be set to allow Manitoba to reduce its emissions to at least 25% below 1990 levels by 2020.⁵

3. Include all sources of accurately measurable emissions

We support the WCI's proposed approach of including all sources of accurately measurable emissions. Taking this approach creates a level playing field across the economy and maximizes the scope of solutions that will be incentivized by the system. We do not support the WCI's proposal to wait until 2015 to include the greenhouse gas pollution from transportation, and residential and commercial heating. There is no administrative barrier to dealing with those sources from the outset, and given the urgency of dealing with climate change, Manitoba should be treating all sectors with the same sense of urgency. B.C.'s carbon tax, which is applied to transportation and heating, demonstrates that WCI jurisdictions do not need to wait until 2015 to apply a carbon price to the greenhouse gas pollution from transportation and heating.

4. Distribute all allowances by auction

The WCI has recommended that a minimum of 10% of allowances be auctioned when the cap-and-trade system launches. If Manitoba were to follow the minimum approach, it would be problematic for three reasons:

- There would be a huge potential for windfall profits and/or unfair subsidies to industry if 90% of the permits were allocated to companies for less than their true value.
- Every allowance allocated below market value would represent lost revenue for the government.
- The system would be more complex because government would need to decide which companies should receive non-auctioned allowances (and which should not).

We were pleased to see that Manitoba left space to exceed the 10% minimum, and it will be important to act on the opportunity. Our recommended approach would be to auction 100% of the allowances to ensure the government is collecting a fair value for the

⁴ The Climate Change and Emissions Reductions Act. Accessed on March 14, 2011 at <http://web2.gov.mb.ca/laws/statutes/ccsm/c135e.php>.

⁵ See Climate Leadership, Economic Prosperity (Pembina Institute and David Suzuki Foundation, 2009) for background on why the 25% reduction target would allow Canada to make an equitable contribution to international efforts to avert dangerous climate change. Accessed on March 15, 2011 at <http://www.pembina.org/pub/1909>.

allowances and the potential for windfall profits is eliminated. Choosing to auction a higher percentage of allowances would not be without precedent. For example, the Regional Greenhouse Gas Initiative, which is a cap-and-trade system operating between ten northeastern U.S. states, recently auctioned 87% of the allowances.⁶ Auctioning 100% of allowances would also be analogous to the carbon tax that B.C. has already implemented.

5. Eliminate or reduce reliance on offsets

The WCI's proposed offset limit (i.e. up to 49% of reductions from the cap-and-trade system coming from offsets) is not stringent enough for several reasons:

- It would undermine investment in the sectors of Manitoba's economy in the cap-and-trade system by depressing the carbon price.
- It would compromise the system's environmental integrity by inevitably rewarding some non-incremental emission reductions.⁷

If the province is going to go to the effort of implementing a cap-and-trade system to reduce greenhouse gas pollution, the vast majority (if not all) of reductions should come from those sectors.

Given the very serious documented problems with offsets⁸, our preferred approach would be to eliminate the use of offsets entirely. The lost flexibility could be addressed by making additional allowances available for purchase (thus lowering the price) if auction prices significantly exceed expected levels. Those thresholds would need to rise to at least \$200 per tonne in 2020.⁹ If the thresholds were exceeded, the government could use a portion of its higher-than-anticipated revenues to invest in incremental emission reductions projects outside of the cap-and-trade system.

If Manitoba does choose to allow some offsets, we would first recommend discounting the compliance value of offsets by at least 20% to provide a buffer to account for the inevitable non-additional offsets.¹⁰ We do not have a specific recommendation for an offset limit, but it should be set so that at least the vast majority of reductions come from the capped sectors.

⁶ Based on numbers reported on the RGGI website. Accessed on March 15, 2011 at http://www.rggi.org/design/overview/allowance_allocation.

⁷ Certifying non-incremental offsets is problematic because it would mean the cap-and-trade system is achieving less environmental benefit than anticipated.

⁸ See "A Realistic Policy on International Carbon Offsets" (Michael Wara and David Victor, 2008) or "Is the CDM fulfilling its environmental and sustainable development objectives? An evaluation of the CDM and options for improvement" (Lambert Schneider, 2007).

⁹ The \$200 per tonne is taken from Climate Leadership and Economic Prosperity (Pembina Institute and David Suzuki Foundation, 2009), an economic modelling study that analyzed the carbon prices needed to make deep cuts in Canada's greenhouse gas emissions.

¹⁰ Schneider (2007) found 20% of offsets from the Clean Development Mechanism were not additional.