the PEMBINA institute **BRIEFING NOTE**

Ensuring Canada's Kyoto plan delivers real emissions reductions: the need for additionality rules in the Offset System

A credit-granting mechanism known as the **Offset System** lies at the heart of Canada's plan to honour its Kyoto Protocol commitment, released by the Government in April 2005. The **Climate Fund** — the single largest element of the plan in terms of emission reductions — will function by purchasing **offset credits** from Canadian projects that reduce greenhouse gas (GHG) emissions. In another key element of the plan, **Large Final Emitters** (heavy industry) will also purchase offset credits to meet their mandatory GHG targets. Projects that could receive offset credits include initiatives in the buildings, transportation, municipal, forestry and agriculture sectors, as well as projects that result in emission reductions in industry and electricity generation that are not already recognized under Large Final Emitter targets.

The ***additionality*** of projects receiving offset credits is the most important consideration for the effectiveness and credibility of the Offset System. ***Additional*** projects are those that are implemented only because of the incentive created by the ability to earn offset credits. ***Non-additional*** projects are those that would be implemented anyway, in the absence of the Offset System, either because

- they are part of "business-as-usual," i.e., they make economic sense on their own,
- they are sufficiently incented or required by an existing federal program,
- they are expected to occur under another part of the federal Kyoto plan, or
- they are sufficiently incented or required by a provincial program or regulator.

In the April 2005 Kyoto plan, the government promised to ensure that "offset credits are not awarded for reductions that would occur in the absence of the offset system" (p.22). Unfortunately, Environment Canada's currently proposed Offset System design[1] ignores this commitment. Additionality, or the need to go beyond business-as-usual, is mentioned neither in the proposed Offset System Principles, nor in the Offset System Rules.[2] If this is because of a desire to use the Offset System to resolve political or regional equity issues, the Pembina Institute urges that other, more appropriate mechanisms, like the Partnership Fund, be used to do so.

Rules to ensure additionality are critical because…

1. The Government needs the tonnes. The gap between Canada's projected emissions and our Kyoto target is large. Given that the target begins to apply in barely two years' time, meeting it will be highly challenging. Every non-additional credit purchased by the Climate Fund or by Large Final Emitters represents a tonne of emission "reductions" that will not count towards Canada's Kyoto target.

2. Public money must be used effectively. According to the April 2005 plan, credits purchased by the Climate Fund will be "retired on behalf of Canada's commitment to Kyoto" (p.21). Bill C-43, which created the fund, requires it to "ensure the cost-effectiveness of the acquisition" of offset credits — a requirement subject to audit by the Auditor General. If the Climate Fund purchases non-additional credits, neither of these requirements will be met.

3. Large Final Emitters' targets have been weakened enough. Emission reductions to be required of industry have already shrunk from 55 megatonnes (Mt) in the November 2002 federal Kyoto plan to just 36 Mt in the April 2005 plan — despite the ability of sectors like oil and gas to take on much larger reductions without economic disruption. Allowing industry to use non-additional offset credits to meet Large Final Emitter targets will, in effect, further weaken those already weakened targets.

4. The Government wants to link Canada's emissions trading system to those of other countries. In February 2005, the Prime Minister mandated the National Round Table on the Environment and the

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[1] *Offset System for Greenhouse Gases Overview Paper* and *Technical Background Document* (August 2005).
[2] Also, no indication is provided that additionality will be ensured through selection of project baselines.

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Economy (NRTEE) to report on "options for linking Canada's domestic emissions trading regime to other countries' domestic regimes." A Canadian offset system in which credits are granted to business-as-usual projects will not be able to link to the more rigorous regimes in place in key jurisdictions like the EU, which currently has the world's largest GHG emissions trading market.

Practical additionality rules have been implemented elsewhere

It is not possible to determine with absolute certainty whether a project would have occurred anyway, in the absence of the ability to earn offset credits. But this is no reason to abandon additionality altogether. The aim must be to establish a balance between rigour and practicality so that rules ensure a strong degree of additionality while remaining straightforward to apply. Experience elsewhere shows this can be done:

The Clean Development Mechanism (CDM) is a credit-granting mechanism under the Kyoto Protocol for emission reduction projects in developing countries. Since being established in 2002, the CDM Executive Board (currently chaired by Canada) has done valuable work to develop additionality rules, now formulated in an Additionality Tool. The tool poses a straightforward series of questions requiring assessment of whether legal alternatives to a proposed project exist, whether the project activity is already common practice, whether the project is hindered by economic or other barriers, and whether the earning of credits will overcome them. The notion that additionality rules are responsible for the slow rate of approval of CDM projects is a myth (see box below).

SenterNovem, an agency that has already contracted to buy 16 Mt of credits from foreign GHG emission reduction projects on behalf of **the Netherlands government**, applies the following additionality criteria. A project's proponent must show either (i) an alternative exists that is more economically attractive; (ii) without the sale of credits the project is not economically viable; or (iii) several significant barriers to the project exist.

Under the **New Zealand government**'s Projects to Reduce Emissions program, very similar to Canada's proposed Offset System, companies proposing projects must provide (i) "an investment assessment to confirm that they are additional to 'business-as-usual'…" and (ii) a "Letter on Additionality" from the CEO affirming that the company would not carry out the project if credits were not granted. To date, 11 Mt of credits have been granted on this basis.

Oregon's **Climate Trust**, which invests in offset projects on behalf of power plants in the state that are subject to regulated GHG limits, applies "stringent additionality quantification requirements," and "reviews projects to ensure that funding provided by The Climate Trust is necessary for the project to move forward."

The CDM's problems are not due to additionality

It has been suggested that additionality has been a major cause of delays in approval of CDM projects. However, there is no documented proof that this is the case — it is a perception only, often supported by project developers whose projects are being questioned. The slow rate of approval of CDM projects is, in reality, a result not of additionality rules but of a dramatic shortfall in the professional resources provided to the CDM Executive Board. Further evidence that the CDM's problems are not due to additionality includes the following:

- The draft paper on improving the CDM prepared by NRTEE in August 2005 made no mention of additionality rules as a cause of problems in the CDM.
- At the Dutch-Canadian Conference on Climate Change (Ottawa, October 2005), the panel on the CDM, which included representatives of the International Emissions Trading Association, the World Bank and the Governments of Canada and the Netherlands, emphasized lack of professional resources, not additionality rules, as the primary concern with the CDM. According to the Dutch government representative, the CDM's additionality rules have added clarity and are working well.

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