David Suzuki Foundation

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Sustainable Energy Solutions

BACKGROUNDER
Western Climate Initiative
San Diego Meeting July 29, 2008

The Western Climate Initiative (WCI), an alliance of seven U.S. states and four provinces -- British Columbia, Manitoba, Ontario and Québec -- is holding its third full stakeholder meeting on July 29 in San Diego. The meeting in San Diego follows meetings in Portland and Salt Lake City, and will be an opportunity to present and discuss the next iteration of the WCI's recommendations. The WCI's design for a regional cap-and-trade system is expected to be finalized in September 2008.

Why is the development of the WCI's cap and trade system important?

- With Ontario joining the WCI last week, the federal government's current approach to climate change policy has been soundly rejected as insufficient. The WCI's proposed cap-and-trade system now represents one of the key policy planks for four provinces accounting for 79% of Canada's population[1] and 49% of the country's total greenhouse gas emissions[2].
- In B.C., where 70% of emissions are already covered by the province's carbon tax, the cap-and-trade system could still cover up to 40% of B.C.'s total emissions. The B.C. government's recent climate plan has modeled a cap-and-trade system in which the market price of carbon dioxide emissions will be $50 per tonne by 2016 and $100 per tonne by 2021[3].
- Because Manitoba, Ontario and Quebec do not have a significant carbon tax, the proportion of emissions that could be covered by the cap-and-trade system is larger. Based on the system envisioned in the WCI's May 21 draft recommendations, this includes emissions from industry, heating, and potentially transportation. In Ontario, these sources account for over 90% of the province's greenhouse gas emissions (industry accounts for 42%, heating is 16%, and transportation is 33%)[4].
- In the same way that B.C.'s carbon tax has been a North American first, the WCI's cap-and-trade system is likely to be a key part of the blueprint for North American action on global warming.

What to watch for at the July 29 meeting, and leading up to the final design in September

- Will the proposed system leave laggard provinces (and their economies) behind? The draft recommendations already propose to penalize dirty electricity coming from jurisdictions that aren't part of the WCI, and a similar approach could be taken for other emissions-intensive products.
- Will Québec, Ontario, and Manitoba adopt the full scope of emissions sources proposed to be covered, or follow B.C.'s approach of covering certain sources of emissions with a carbon

[1] Canada's population estimates, first quarter 2008 [preliminary]. Statistics Canada (2008).
[2] *National Inventory Report 1990–2006*. Government of Canada (2008).
[3] *British Columbia's Climate Action Plan*. Government of British Columbia (2008).
[4] *National Inventory Report 1990–2006*. Government of Canada (2008).

tax? B.C. has implemented a carbon tax on transportation and heating fuels that would work in place of a cap-and-trade system.

- Will the final recommendations for the program's scope live up to the goals in the draft proposals? The draft recommendations propose regulatory thresholds low enough to capture 90% of the emissions within each regulated sector. Weakening this commitment would unnecessarily exempt some large polluters, such as parts of B.C.'s oil and gas sector.
- How many pollution permits will be allocated to Canadian provinces within the WCI trading system? B.C.'s emission reduction target is 33% below 2007 levels (or 10% below 1990 levels) by 2020, while Ontario's is 15% below 1990 levels by 2020.[5] While these targets are less stringent than what would be required to contribute to a global effort to prevent dangerous levels of climate change, the cap-and-trade system will, at a minimum, need to ensure they are achieved.
- Will the cap-and-trade system follow the lead of B.C.'s carbon tax by adopting a polluter-pays approach where 100% of the pollution permits are auctioned? The draft WCI recommendations from May 2008 could still allow up to 75% of those permits being given away for free to polluters.
- Will the cap-and-trade system close potential loopholes that would allow too many and/or low quality carbon offsets? The draft recommendations are unclear about how many offsets will be allowed in the system and what quality of offset will be required. If the next iteration of the WCI recommendations fails to close these potential loopholes, the system's environmental integrity could be compromised.
- Will the WCI act quickly to ensure that the system be operational by 2009? If 2009 proves to be too tight a timeline for the entire WCI, will the provinces act to implement an interim price on greenhouse gas emissions (e.g., a smaller cap-and-trade system or a carbon tax) in advance of other WCI jurisdictions?
- Will Ontario follow other WCI members, and practically all other provinces in Canada, in supporting California's tailpipe standards for cars and trucks? These types of stringent standards will need to complement the cap-and-trade system for provinces to achieve deep reductions in greenhouse gas emissions.

What is the Western Climate Initiative?

- The Western Climate Initiative was established by the governors of Arizona, California, New Mexico, Oregon and Washington in February 2007 to reduce greenhouse gas emissions in the region.
- B.C. and Manitoba joined the initiative in 2007, followed by Québec in May 2008 and Ontario in July 2008.
- The initiative now includes seven U.S. states and four Canadian provinces, representing a total population of 84.6 million people.[6]
- The WCI's current focus is on developing a regional cap-and-trade system.

What's the purpose of a cap-and-trade system?

- The cap-and-trade system is one approach to address a fundamental problem in our economic system – there are currently no limits on greenhouse gas emissions and no cost to pollute.

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[5] *Provincial Power Play*. David Suzuki Foundation (2008).

[6] Canada population estimates Jan 1, 2007. Statistics Canada (2007); National and state population estimates for July 1, 2007. US Census Bureau (2007).

- If well designed, this system will spur companies and industry to develop innovative ways to reduce global warming emissions while protecting economic competitiveness.
- This market-based policy/economic tool encourages large industrial emitters and other sectors to reduce their emissions by investing in or developing their own innovative clean energy technologies, or improving the energy efficiency of their operations.

How a cap-and-trade system works

- A cap-and-trade system limits (or caps) the overall level of emissions from industry and other sectors and reduces that limit year after year.
- The government creates and distributes "pollution permits" equal to the cap for the year.
- As the cap decreases year by year, companies are required to reduce their emissions to the same level as the number of permits they hold, or they can try to buy permits from other companies.
- Companies that are able to reduce their emissions cheaply could have excess emission permits, which they could sell to companies that don't have enough permits to cover their emissions.
- In this way, the emission cap ensures that total pollution goes down and companies are given an economic incentive that motivates them to find better ways to reduce harmful greenhouse gas emissions.
- The emission permits become the common trading "currency," and the market value of the permits places a price on emissions.
- It is a cost-effective approach to reducing emissions as it encourages the cheapest emission reductions to happen first.
- A well-designed cap-and-trade system can be an effective means of reducing greenhouse gas emissions for large parts of the economy, but it is not a silver bullet. Complementary policies, such as regulations on the energy efficiency, strategic investments in infrastructure, and support for research, development and demonstration programs are also necessary to jump-start the transition to a low-carbon economy.[7]

Examples of cap-and-trade systems

- Cap-and-trade has been successfully used in the U.S. in reducing emissions of sulphur dioxide and nitrous oxide, the two key ingredients that cause acid rain. Since 1995, this cap-and-trade system has reduced some acid rain forming emissions by 40% [8]. The initial implementation costs were much lower than forecast under a regulatory quota approach. Total annual implementation costs have continued to decline over time.[9]
- The European Union has had a cap-and-trade system in place since 2005 to reduce greenhouse gas emissions from more than 10,000 large industrial emitters in 27 countries.
- British Columbia, Manitoba, Ontario and Québec can learn from these earlier experiences to design an effective system from the start.

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[7] *Getting to 2050: Canada's Transition to a Low-emission Future*. National Roundtable on the Environment and Economy (2007).

[8] *Acid Rain Program 2006 Progress Report*. US EPA (2007).