



# Publication

## ENVIRONMENT BULLETIN

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### MARKET AND NON-MARKET MECHANISMS TO CURB EMISSIONS – UPDATE ON CLIMATE CHANGE

Despite a recent re-focusing of political and public attention on the economy, governments continue to work on the issue of climate change. Over the past several months we have seen a number of sub-national and international developments touching on climate policy. These may be broadly categorised as either “market” or “non-market” in nature (see Box 1 on page 2). This issue of the Business Council’s *Environment Bulletin* reviews these developments with a focus on the potential regulatory and competitive implications for business and industry in British Columbia.

#### 1. Market developments

##### *Final WCI plan*

The final design recommendations of the Western Climate Initiative (WCI) were released on September 23, 2008. Much of the document is consistent with the approach taken by the WCI partners in earlier drafts. However, a review of the accompanying background material signals some new thinking that – should the WCI actually become operational – will affect the operation of the proposed cap & trade system.

In brief, the proposed design:

- indicates that allowances will be distributed independently, except for those sectors where competitiveness concerns dictate a coordinated approach. Partners will initially auction a minimum of 10 percent of allowances, rising to 25 percent by 2020;
- suggests that, while allowance apportionment methodology is still under review, each WCI partner’s 2012 allowance budget will be based on the “best estimate of expected emissions” from covered sources in that jurisdiction. The total allowances apportioned among the WCI partners is intended to equal the regional cap;
- provides that in the final design recommendations, partners may issue Early Reduction Allowances (issued outside the cap), in recognition of voluntary reductions after January 1, 2008 and prior to the 2012 commencement of the cap & trade scheme;
- accepts that offsets and allowances from other trading systems may be used for up to 49 percent of an emitter’s compliance obligation, with partners having discretion to set a lower limit if desired.

As proposed, the cap & trade system will cover approximately half of the WCI region’s GHG emissions in the first compliance period, rising to 90 percent in the second in the



event that the scheme expands to encompass transportation and building emissions. It remains unclear whether these latter sources are best addressed within a cap & trade system, or via some of the non-market mechanisms that have been enacted or proposed in British Columbia and elsewhere.

The WCI design recommendations provide that almost half of an emitter’s compliance obligation can be met through investing in offsets. However, the orientation of WCI’s offsets program to favour “collateral benefits” that are by definition local in nature (health, social and other environmental) is likely to tilt the playing field to projects within WCI jurisdictions. The emphasis on co-benefits to offset projects can interfere with the principal goal of a market-based climate policy and runs counter to the “global problem, global solution” concept concerning climate change.

In terms of next steps, WCI partners are working to produce a final overall work plan arising from the recommendations, to be released early in 2009. A revised WCI subcommittee structure has been established, and staff are engaged in detailed analysis and policy development, including crafting a model rule and determining methodology for allocation and distribution of allowances. Since some partners still need to seek legislative approval to participate in a WCI cap & trade regime, it may be premature for the jurisdictions to finalize a work plan on the basis of recommendations that may or may not be taken up at the political level.

Finally, given the outcome of the US presidential election, the Business Council’s view is that a regional WCI cap & trade system probably will never come into being. Instead, the WCI is likely to serve as a “policy laboratory” for Washington policymakers to ponder in developing a national US cap & trade scheme. The recent Canadian government offer to collaborate with the new US administration on a harmonised approach to climate change suggests that Ottawa is positioning to address this policy issue in a North American context.

*BC Regulations: Greenhouse Gas Emissions Reporting Intentions Paper*

BC is proceeding with regulatory aspects of the province’s commitment to a cap & trade program. The BC Ministry of Environment proposes to require mandatory reporting of all GHG emissions by entities emitting 10,000 tonnes or more of CO<sub>2</sub>e per year. At the 25,000 tonne compliance obligation threshold, the Ministry of Environment estimates that approximately 80-100 facilities would be covered, while at the 10,000 tonne reporting threshold another 160 - 180 facilities would be captured. While many Business Council

<p><b>Box 1: Market &amp; Non-Market Climate Change Policy Mechanisms</b></p> <p><i>Market Mechanisms (within a cap &amp; trade system)</i></p> <ul style="list-style-type: none"> <li>• Allocation method (auction and/or free)</li> <li>• Offset credits</li> <li>• Price ceiling</li> <li>• Banking &amp; borrowing</li> </ul> <p><i>Non-Market Mechanisms</i></p> <ul style="list-style-type: none"> <li>• Fees (e.g. CA high GWP Mitigation Fee)</li> <li>• Taxes (e.g. BC carbon tax)</li> <li>• Standards (e.g. CA Pavley vehicle standards, building/energy efficiency programs)</li> <li>• RPS (renewable portfolio standard)</li> </ul>
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members have the capacity to fulfill the proposed reporting requirements, many smaller industrial and commercial facilities will struggle to meet an obligation of which many are currently not even aware. The aggregate environmental regulatory burden on BC business and industry is increasing as the government moves to implement various elements of its climate change and energy policies at a time when the province's economy is falling into recession. (The Business Council's submission on the province's Reporting Intentions Paper is available at: [http://www.bcbc.com/Documents/EN\\_20081128\\_Submission\\_GHGReporting.pdf](http://www.bcbc.com/Documents/EN_20081128_Submission_GHGReporting.pdf))

### *California Scoping Plan*

In October 2008 California released its proposed Scoping Plan – the state's climate change policy framework and strategy document. It covers a mix of market and non-market measures designed to achieve the GHG reduction goal set out in Assembly Bill 32 (which commits California to reduce its carbon emissions to 1990 levels by 2020). The Scoping Plan reaffirms California's commitment to participate in the WCI, which by 2020 is estimated to cover 85 percent of California's emissions (including transportation and buildings in 2015). However, the Scoping Plan addresses other, non-market approaches to reducing GHG emissions, including additional measures for various industry sectors (discussed in brief below).

## **2. Competitiveness Issues Addressed via Market Mechanisms**

At the international level, Australia's recently-released climate plan sheds light on some of the thinking in other jurisdictions around competitiveness in the context of greenhouse gas reduction strategies.

### *Australia – ways to address Emissions Intensive Trade Exposed (EITE) Industries*<sup>1</sup>

In releasing its proposed climate change plan, Australia devoted an entire chapter to addressing EITE industries. The plan considers various ways emissions leakage can be minimised and competitiveness can be protected for these industries, and proposes that this is best accomplished within the proposed cap & trade market mechanism. Australia intends to take into account the impact on sectors of carbon constraints as long as its key competitors remain uncovered by similar constraints.

Australia proposes to approach its assessment of the vulnerability of EITE industries by calculating industry-wide emissions from a process or activity to ensure assistance is well-targeted and equitable within and between industries. The assessment of an industry's exposure would then use an intensity-based emission factor per unit of revenue, rather than overall emission amounts (the factor is proposed to cover 60 percent of emissions above 1,500 tonnes of CO<sub>2</sub>e per million dollars of revenue, and 90 percent of emissions above 2,000 tonnes of CO<sub>2</sub>e per million dollars of revenue). The rationale is that this would be

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<sup>1</sup> Australian Government (2008). *Carbon Pollution Reduction Scheme Green Paper, Chapter 9 Assistance to emissions-intensive trade-exposed industries*. Department of Climate Change, Commonwealth of Australia. Accessible via <http://www.climatechange.gov.au/greenpaper/report/pubs/greenpaper-ch9.pdf>.



the most transparent and comparable indicator of the significance of carbon cost impacts across trade-exposed industries.

### 3. Non Market Developments

A number of non-market mechanisms are being introduced or have been proposed in various climate change plans. These complementary measures are likely to accompany any major market-based initiatives, as they tend to cover such areas that are not easily covered by cap & trade systems as are industrial and electricity point sources.

#### *California Scoping Plan*

A number of complementary measures are proposed by California that may expose industry and consumers to additional compliance requirements and fees. While there is little appetite in other WCI jurisdictions – or federally in Canada or the US – for any kind of carbon tax, there is little doubt that costs in the form of fees or other price-based mechanisms will form part of comprehensive climate change schemes, including in California. The state’s final proposed Scoping Plan includes a Mitigation Fee associated with products containing high global warming potential (GWP) gases. It appears that this fee is to be applied in addition to the potential coverage of the producing sector by the WCI. Other non-market mechanisms proposed in California’s Scoping Plan relate to clean car standards (the “Pavley standards”) and a suite of energy efficiency measures. Concerning the Pavley standards, the present uncertainty over whether California will receive the Environmental Protection Agency waiver it needs has resulted in an alternative “feebate” plan being proposed that would reward consumers for low-emission vehicles and penalize them for high-emitting vehicles.

### 4. Conclusion

As various jurisdictions continue to grapple with regional, national and sub-national climate change policies, important lessons are emerging for policymakers. One key lesson is that the trade and competitiveness implications of regional strategies argue for a concerted post-Kyoto effort to develop a global framework for climate change policy. Another lesson is that market mechanisms can only be expected to help achieve emissions reductions in easily-captured industrial and electricity generation sectors. Complementary, non-market policies will no doubt be part of comprehensive climate change plans going forward. These, too, have the potential to distort markets and affect competitiveness and thus will require careful assessment. As British Columbia and Canada continue to pursue their climate initiatives, they should be looking to achieve policy **collaboration** with other jurisdictions, protect the **competitiveness** of BC and Canadian industry, and ensure internal **coherence** in market and non-market policy development.

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