



**Smart Prosperity
Institute**

SUBMISSION

TO THE CANADIAN COUNCIL OF MINISTERS
OF THE ENVIRONMENT ON THE PROPOSED
PAN-CANADIAN OFFSET FRAMEWORK

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Introduction

Smart Prosperity Institute (formerly Sustainable Prosperity) welcomes the opportunity to provide comments to the Canadian Council of Ministers of the Environment (CCME) on the development of a pan-Canadian offset framework, as outlined in the series of four discussion papers.

Smart Prosperity Institute is a national research network and policy think tank based at the University of Ottawa. We deliver world-class research and work with public and private partners – all to advance practical policies and market solutions for a stronger, cleaner economy.

While we do not have technical expertise in offset protocol development, Smart Prosperity Institute has expertise in low carbon policy, carbon pricing policy, and in how the suite of low carbon policies can work together as a whole. In this spirit, we offer both some high-level general commentary on carbon offsets, followed by more specific comments on particular aspects of the draft framework. Do not hesitate to contact us for more information or clarification if needed.

General Commentary

Smart Prosperity Institute commends the Canadian Council of Ministers of the Environment for its work to examine options for a pan-Canadian offsets framework. With offset systems already in place or under development in jurisdictions across Canada (and more likely to follow), having a consistent and robust approach to offsets across jurisdictions can be an important part of the Pan-Canadian approach to climate change.

When well designed, greenhouse gas (GHG) offset programs have the potential to complement existing climate policy by extending emission reduction incentives to unregulated sectors/activities, reducing compliance costs, attracting investment in GHG reduction projects, and stimulating clean innovation.

However, it is important to note that carbon offsets shift the sector in which emissions reductions take place but do not generally result in net emissions reductions. Further, ensuring generated offsets are truly additional to what would have otherwise occurred presents a significant challenge.

In line with these realities, we support carbon offsetting and believe a pan-Canadian offsets framework would help reduce compliance costs for regulated firms and could enable greater harmonization of provincial and territorial carbon pricing efforts; however, we caution that the details of the framework – including the protocols which it may come to include – are extremely important.

In helping to develop the pan-Canadian framework, CCME is playing an important intergovernmental coordination role to ensure an effective system is developed, which may be



particularly important for small jurisdictions that may not have the resources to develop stand-alone offset frameworks. Smart Prosperity Institute encourages CCME to continue to play this important role.

Specific Comments

Fungibility - Towards a Common Canadian Offset Market

As the first discussion paper of the four states, “The principles, guidelines, best practices and standard elements of the framework will be non-binding on jurisdictions operating their own offset program and would facilitate offset project development in those jurisdictions where a sub-national program does not exist.” This non-binding nature of the framework should encourage consistency in offset programs and facilitate the use of offsets programs by smaller jurisdictions – should they so desire – who might not have resources to develop their own frameworks.

Creating an offset market with fungibility between participating provinces has the potential to reduce compliance costs by providing participants access to (potentially) lower-cost abatement opportunities wherever they may occur in the country. Previous modelling by Smart Prosperity Institute and the International Institute for Sustainable Development (IISD) looked at \$25/tonne carbon pricing scenarios with and without offsets (in the 2011 policy landscape) and found that the inclusion of a common offset market could reduce the cost of compliance by as much as 42%.¹

In addition to lowering abatement costs overall, using a common offset market serves as a way of linking different carbon pricing systems across Canada and can act to harmonize carbon prices around the price of offsets.² Ensuring similar carbon price levels across Canada is an important competitiveness concern in some provinces. It is worth noting, however, that it would also create capital flows between provinces/regions, which is presently restricted in BC’s and Alberta’s offset programs and could face opposition.

Fungibility – Potential to Link with International Markets

In addition to acting as a form of link between Canadian jurisdictions’ carbon pricing systems, a pan-Canadian offset system has the potential to link with international jurisdictions’ systems.

¹ Sawyer, D., Stiebert, S., and Beugin, D. (2011) [Offsets and Canada’s GHG Regulations; Reducing costs, improving competitiveness and lowering emissions](#), Smart Prosperity Institute (formerly Sustainable Prosperity) and the International Institute for Sustainable Development.

² Canada’s Ecosystems Commission (2015) [The Way Forward: A practical approach to reducing Canada’s greenhouse gas emissions](#).



Quebec is at the forefront of international carbon market development through its link to California with the Western Climate Initiative³ (WCI), soon to be joined by Ontario.⁴ The WCI system allows firms to use offset credits generated in either jurisdiction to cover up to 8% of a facility's emission reduction obligation.⁵ By linking with an economy larger than all of Canada, Quebec and Ontario gain access to an enormous market with potential to generate lower-cost emissions reductions. While this is cost-effective and has no impact on the total GHG reductions, it is essentially a transfer of capital to Californian entities to reduce emissions in order to meet regulatory obligations in Canada (or vice versa).⁶

Linkages with international offset markets may prove to be an important consideration in the development of the pan-Canadian offsets framework, which could perhaps be given greater exploration in the framework documents. In principle, the more jurisdictions covered with a common offset framework, the greater the efficiency and lower the cost of emissions reductions; however, previous experience with international offset markets argue for learning from past experience and exercising caution⁷ and following robust design principles to ensure system credibility. In particular, Canada is an eager participant in current discussions to develop Internationally Tradeable Mitigation Outcomes (ITMOs) under Article 6 of the Paris Agreement. Most immediately relevant, with the recent US announcement that it intends to withdraw from the Paris Agreement, the implications for jurisdictions counting on emissions reductions secured through carbon offsets (such as Ontario and Quebec) are not clear – will these emissions reductions count as ITMOs in order to count towards Canada's national target? These concerns and uncertainties may make a pan-Canadian offsets framework all the more helpful in securing lowest-cost emissions reductions within Canada; however, greater understanding of the potential linkages of the framework with the international framework(s) would be helpful.

Key Design Elements

Smart Prosperity Institute agrees with CCME's statements that effective GHG offsets must be real, additional, verifiable, permanent, and enforceable. We would like to underline the importance of these principles and add predictability as an important design element.

Real - An offset must accurately represent at least one tonne of avoided or sequestered GHG emissions from the actions of the project. As CCME notes, estimation of emissions avoided must therefore be conservative and based on sound methodology to avoid overestimating and over-allocating offset credits.

³ Ministère du Développement durable, de l'environnement et de la lutte contre les changements climatiques (n.d.) [The Québec Cap-and-Trade System for Greenhouse Gas Emission Allowances](#)

⁴ Morrow, A. (2015) [Quebec and Ontario Unveil Joint Plan to Tackle Companies Carbon Emissions](#), *The Globe and Mail*.

⁵ Purdon, M., Houle, D., and Lachapelle, E. (2014) [The political economy of California and Quebec's cap-and-trade systems](#), *Smart Prosperity Institute (formerly Sustainable Prosperity)*.

⁶ It is worth noting that the future of the WCI is uncertain with new proposed regulations in California to revamp its cap and trade system.

⁷ Schneider, R. and Kollmuss, A. (2015) [Perverse effects of carbon markets on HFC-23 and SF6 abatement projects in Russia](#), *Nature Climate Change*, 5:1061-1063.



Additional - Offset programs only work when offsets are generated from activities that would not have otherwise occurred. This includes accounting for emissions leakage that comes as a result of an offset project.

Verifiable - Engaging an objective third-party to review and verify offset projects is essential to ensure their legitimacy. In an inter-jurisdictional common market, having a transparent offset registry that is publicly available is an important element to avoid double counting.

Permanent - Ensuring reductions for offset credits cannot be reversed is an imperative to the efficacy of an offset program. This can be addressed by incorporating robust enforcement and verification elements to avoid intentional reversal as well as policy mechanisms such as buffer accounts to hedge against risk of unintentional reversals.

Enforceable – Including minimum monitoring and enforcement standards in the pan-Canadian offset framework can help provide certainty that principles will be applied across jurisdictions.

Predictable - Offset protocols and offset projects take time to develop, therefore developing an offset framework that provides predictability for future standards and consistency across jurisdictions can help provide the certainty necessary for organizations to invest in offset projects and clean innovation. Ideally, the creation of offsets themselves would also be somewhat predictable, so as to ensure a liquid market without significant unpredicted offset supply fluctuations.

Key System Design Considerations

The core design elements noted above impact the overall effectiveness of the system, and they are influenced by a number of critically important design considerations.

Baseline setting - With the broad array of mitigation, adaptation, and cleantech efforts currently underway or in development at the federal, provincial/territorial, and municipal levels, as well as by the private sector, ensuring additionality of offsets becomes particularly important. The challenges in ensuring additionality are exemplified by British Columbia's recent experience using offsets to achieve a carbon neutral government⁸ and will only become more difficult as new efforts to achieve clean growth and climate goals come into force – including initiatives as varied as the clean fuel standard, agricultural policy framework, forestry sector economic support packages, and circular economy initiatives. Accurate baseline setting plays an important role and baselines must be continually adjusted over time to reflect the regulatory, financial, and technological

⁸ Auditor General of British Columbia (2013) [An Audit of Carbon Neutral Government](#), Office of the Auditor General, Report 14: March 2013.



reality. Further, the eligible time period in which activity can create offsets is critically important; we would caution against using a start date that has already passed, particularly for any jurisdiction in which an offset system has not yet been implemented, and that baselines be very carefully chosen. Taken together, these ensure that actions are incremental/additional and that emissions reductions are real.

Coverage -- Offsets have potential to extend emission reduction incentives to unregulated sectors/activities, however offsets used to comply in regulated industries therefore do not create any *additional* emissions reductions from the unregulated sector -- the reductions are simply moved to a sector/activity with lower abatement cost. Therefore, careful consideration of which sectors and activities are eligible to generate offsets is critically important. Some jurisdictions may prefer to encourage emissions reductions from activities through policies/regulations other than offsets, which would allow them to be additional to the voluntary market and to regulated industries' emissions reductions.

Institutions

Creating valid and robust offset protocols can be challenging and resource intensive, therefore a coherent pan-Canadian framework can be useful to support a jurisdiction's use of offsets. Centralized/harmonized offset systems have higher start-up administration costs but lower operational costs by reducing transaction costs and duplication of effort for regional authorities.⁹ In contrast, less centralized systems have higher transaction costs for buyers and developers but can offer more variety and flexibility in project types and protocol choices.¹⁰ Development of a pan-Canadian offset framework should take into consideration the existing expertise and experience developed around Canada with the institutions and protocols already in place and evaluate the opportunity for a central authority to support jurisdictions by streamlining the protocol development and approval process.

This raises an important question regarding the stated objective of the discussion paper with regards to developing a voluntary pan-Canadian framework from which any jurisdiction could opt-out: will jurisdictions be able to opt-in/out of different aspects of the framework (such as relying on a central institution but only allowing offsets from certain protocols, or vice versa)?

Co-benefits

While GHG offsets do not result in net emissions reductions, they can have other environmental and economic co-benefits. A report by Imperial College London (and funded by International Carbon Reduction and Offset Alliance) to quantify co-benefits suggests that each tonne of CO₂

⁹ Sawyer, D., Stiebert, S., and Beugin, D. (2011) [Offsets and Canada's GHG Regulations; Reducing costs, improving competitiveness and lowering emissions](#), Smart Prosperity Institute (formerly Sustainable Prosperity) and the International Institute for Sustainable Development.

¹⁰ Ibid.



abated results in an additional US\$664 in co-benefits, largely from the provision of ecosystem services, but also through economic and social benefits like tech transfer and infrastructure.¹¹

In particular, a well-designed offset program can support clean innovation and create opportunities for small-medium enterprises (SMEs). Testing projects for technological and financial additionality can help support innovation by creating markets and finance opportunities for early-stage technologies.

The fact that GHG offsets create (largely local) co-benefits can be interpreted as an argument for limiting their use to a particular region or jurisdiction, so that these benefits accrue within the same area (or country). While this may lessen the cost-effectiveness of the offset system in helping regulated industry achieve GHG emissions reductions, it is an important consideration that policy-makers in each jurisdiction may wish to consider.

Other Points

Once the development of the framework moves beyond the level of core principles, a number of supporting elements will require consideration. For instance, the inclusion or not of forward-crediting (in which offsets expected to be created in future years can be sold in advance), insurance for non-permanent offsets (such as may be the case in forestry or agriculture), and pooling of offsets (most relevant where permanence is a concern) should all be discussed.

Summary

Smart Prosperity Institute commends the Canadian Council of Ministers of the Environment for its work to examine options for a pan-Canadian offsets framework. Offsets represent an important and high-potential policy area for reducing GHG emissions at the lowest cost, extending incentives outside beyond regulated sectors, and accelerating clean innovation, however also presents enormous challenges to effective design and implementation.

We would welcome the opportunity to continue to engage throughout the development of the Framework.

¹¹ Makuck, Z., Kountouris, I., and Feng Tan Loh, E. (2014) [Unlocking the hidden value of carbon offsetting](#), *Imperial College London and International Carbon Reduction and Offset Alliance*.