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A Presentation to the Standing Committee on Environment and Sustainable Development

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Mr. Chairman and Committee members, I'd like to thank you very much for providing me with this opportunity to speak before you. I would like to focus on three issues:

1. the so-called Kyoto Mechanisms;
2. Canada's engagement with developing countries on climate change; and
3. our role in developing a global climate change regime after 2012.

Canada must purchase internationally

When Canada signed on to its Kyoto Protocol target of reducing greenhouse gas emissions to six per cent below 1990 levels, it only agreed to do so because it would be able to acquire reduction credits through low-cost investments outside its borders. As an aside, I would just like to note that in 1997, when the Kyoto Protocol was being negotiated, it is my understanding that the strongest supporters for the Kyoto Mechanisms were energy-intensive industries and provinces, and its most vocal opponent was the EU. How odd, therefore, that we now see the EU well on its way in establishing an emissions trading regime, while industry and provinces here condemn such activities as throwing money away for no environmental benefit.

The basic premise behind the Kyoto mechanisms is straightforward. Climate change is a global problem and one tonne of reductions in CO_2 anywhere in the world has the same effect. Therefore, the regime provides incentives for investors to pursue the lowest-cost reductions. Thanks to the Kyoto targets, carbon and other greenhouse gases now have an international economic value and, therefore, a market for trading. This creates an avenue for governments and the private sector to identify the most economically efficient means by which to achieve a desired environmental goal.

The Kyoto Mechanisms, if properly designed and implemented, can provide Canada with a number of significant benefits:

- they will significantly reduce the cost for Canada to meet its Kyoto target;
- they will signal that Canada does plan to be an important player in the growing global carbon trading market;
- they will provide Canadian clean technologies with technology funding opportunities; and
- they will provide Canada with an opportunity to demonstrate global leadership, helping other countries experience, first hand, how climate-friendly investments can also complement and contribute to stable economic growth.

Hence, it should come as no surprise that Canada is planning to take advantage of these so-called Kyoto Mechanisms to reach its target. Nor will Canada be alone—the Netherlands, Japan, Denmark and Norway, to mention a few, will all be actively engaged in the global carbon market. What should give us pause for reflection, however, is how many of these international credits we will actually need to meet our Kyoto targets, and from where we will purchase these credits.

We have dithered for at least 10 years before finally laying out a plan that seriously addresses how we can realistically achieve Kyoto. And when it comes to GHG reductions in Canada, time is most definitely money. We simply do not have the time or resources to meet our Kyoto targets without access to these international opportunities. Those purchases will not be insignificant—probably in the range of 80–100Mt for each year of the Kyoto period.

Given the likely size of our purchase portfolio, it is critical that Canada's international purchases strategy be progressive and carefully thought through. This requires a clear understanding of what the Kyoto Mechanisms can and cannot achieve.

The Kyoto Mechanisms

The Kyoto Protocol allows for two types of international purchases:

1. **project-based emissions reductions**; and
2. **allowance-based reductions.**

1. Project-based emissions reductions

These must demonstrate that real reductions in greenhouse gas emissions occur as a result of that particular project's activities. There are two project-based mechanisms recognized in the Protocol: the **Clean Development Mechanism (CDM),** as defined under Article 12; and **Joint Implementation (JI)**, as defined under Article 6. The CDM provides countries like Canada with the opportunity to help meet their target by making emission reduction investments in developing countries—that is, countries without any commitments to reduce their emissions.

JI refers to greenhouse gas reduction investments in another country with a Kyoto emissions limitation target.

While theoretically attractive, the fact is that both of these mechanisms are having difficulty in getting started. The transaction costs associated with proving that the emissions reductions are better than the "business as usual" scenario can be very expensive and most estimates now are that no more than 200–300 Mt will be available, globally, for each year of the Kyoto Protocol. While the CDM is off and running (so to speak—two projects have so far been approved), JI is still dormant until 2008.

2. Allowance-based reductions

These are referred to as **International Emissions Trading (IET)** in Article 17. It allows developed countries to buy and sell parts of each country's **Assigned Amount Units (AAUs).** Transaction costs under IET are of an order of magnitude lower than project-based reductions, since no time or money needs to be spent on meeting the "additionality" requirement.

Use of this mechanism has become a controversial issue, since it could conceivably allow a country like Canada to completely meet its targets by simply purchasing excess credits from a country like Russia, which has a huge amount of surplus emission credits available as a result of its moderate target and collapsing (but now recovering) economy. Canada, like most of the other Kyoto Parties, has made it clear that it will not be interested in any "hot air" purchases from Russia.

So, where does this leave us? Canada needs to engage in international purchases in order to meet its target, but has decided not to purchase Russian “hot air” and serious concerns have been raised regarding the viability of the Clean Development Mechanism. Given this context, Canada needs to give particular attention to more creative avenues through which to engage in the international purchases required to assist it in meeting its target. It needs to consider the establishment of a **Green Investment Scheme (GIS)**.

Allow me to explain. In response to the concerns expressed about these so called “hot air” transactions, some four years ago, Russia launched the concept of Green Investment Schemes. The idea behind the GIS is relatively simple—revenues collected through International Emissions Trading could be earmarked for environmentally-related purposes in the seller countries, and purchasing countries could also use it as a way of promoting appropriate climate-change-friendly technologies. In other words, investments could be tracked to make sure that they are used to help further reduce emissions in the host country.

The attraction of the GIS is that because it is an emissions trading arrangement, it would not be subject to the same high transaction costs as JI or CDM transactions. Hence, it would be much more cost effective for Canada to pursue an international portfolio that includes both project-based (particularly with developing countries) and allowance-based reductions, with the latter operating under a GIS framework. A well-functioning GIS could ensure that revenue generated through the sale of emission permits is not misused and instead is spent on projects that will provide long-term benefits at the local, national and international level. It can also be used as a mechanism to promote and diffuse climate-change-friendly technologies, advance energy efficiency, and encourage biodiversity and conservation.

Under a GIS, a condition of the international purchase made by Canada would be that the revenue gained by, for example, Ukraine, would be earmarked for a specified use. The financial flows could be directed towards projects that lead to additional emission reductions or clearly demonstrate that they have helped to build capacity in Ukraine to address climate change, contribute to local sustainable development objectives, and contribute to Canadian values and interests.

My selection of Ukraine in the above example was not random. I believe that Canada has a real opportunity to meet multiple objectives through creative application of a Green Investment Scheme with this country. Our desire to support the new Ukrainian government under President Viktor Yushchenko; our longstanding political, cultural and trade relationships; our ability to provide Canadian technologies and expertise to support the transition of their economy—all of these factors create a unique opportunity to engage with Ukraine in a new partnership that will facilitate economic growth with an emphasis on energy efficiency and new technologies while providing Canada with access to international emission reduction credits.

Similar arrangements may be made with other countries with economies in transition such as Bulgaria and Romania. Canada needs to be clear that when it is saying no to “hot air,” that it is not saying no to cooperation with Russia and Ukraine on climate change. The Green Investment Scheme has the potential to allow countries with economies in transition to “leapfrog” past current inefficient technologies they might be considering and look at new technologies that deliver greater efficiency.

I understand that the EU and Japan are already talking with Russia and Ukraine, and others, including Bulgaria, to conclude GIS agreements that would provide both environmental and clean technology benefits for the purchaser and buyer. The Government of Canada, with leadership from Finance, should make sure Canada takes an early initiative in the GIS discussions, even as the government further develops its views on how best to manage its international portfolio.

Post-2012 Regime

Positive engagement with countries in transition and developing countries through international emission purchases will not only help Canada reach its emissions target, it is also critical to the larger issue of engaging the global community in addressing climate change in the long-term. Canada needs to invest in major emitting countries like China, India and Russia so that they can see, on the ground, that sustainable measures that reduce greenhouse gas emissions can work to the good of the economy. Until they are confident of this, they will not be prepared to take on significant reduction commitments.

And as the Intergovernmental Panel on Climate Change made clear in its latest report, the science clearly shows that global emission reductions need to be reduced to 80 per cent of their 1990 levels to truly address climate change. Reaching this goal will require the engagement of all countries—developed and developing—in emission reduction activities.

Negotiations regarding the structure and goals of a second commitment period could begin as early as this November at the Eleventh Conference of the Parties to the United Nations Framework Convention on Climate Change. Effective implementation of the Kyoto Protocol will have a critical influence on these negotiations. By demonstrating to non-Kyoto and developing country parties that industrialized countries are committed to meeting their reduction targets, Canada can show that it is possible to reduce greenhouse gas emissions while maintaining economic growth, and put in place the carbon markets and/or tools and incentives needed to demonstrate the benefits of participating. Joint Implementation, the Clean Development Mechanism and a Green Investment Scheme all contribute to assisting developing countries and countries with economies in transition to put in place the technology, policies and economic systems needed to take on new commitments that will result in real emission reductions.

Canada has an opportunity to lay the groundwork for effective engagement of key developing countries in March when the United Kingdom hosts a meeting of Energy and Environment Ministers from about 20 countries to consider how to achieve a sustainable, secure, low-carbon energy future by 2050. Prime Minister Blair has made climate change a focus area for his tenure as G-8 President, setting as one of his goals furthering global cooperation on climate change, including engaging the United States and key developing countries. It is critical that Canada fully support Prime Minister Blair in his efforts to achieve these aims.

Before closing, I would also like to note the continuing and critical need to assist developing countries in addressing climate change. It is the most vulnerable members of our global community that are expected to experience the greatest adverse effects of the impacts of climate change. There is a critical equity issue here. It is a fact that the peoples least responsible for the threat of climate change—the Dene and Inuit in Canada, the people of small island states and Sub-Saharan Africa— are the ones to be most immediately and directly impacted by it.

The one consistently bright picture Canada has shown in the last 10 years of negotiations has been in the area of financial and capacity-building support to developing countries. That however, is now in serious danger—The Canada Climate Change Development Fund (CCCDF) terminates at the end of March, with no clear plans yet in place for its replacement. The CCCDF has played a critical role in demonstrating to developing countries Canada's commitment to the climate change issue, and I urge this committee to develop plans for its successor.

Conclusion

Canada is on the cusp of a new stage of addressing climate change. Decisions made today will set the course for our participation not only in the first commitment period, but in those that follow. Through solid policy development and implementation, Canada's efforts to meet its Kyoto target will create important economic, social and environmental benefits for our country today and position us to take a leadership role in the economy of the future. The Kyoto Mechanisms can provide a significant tool in reaching these objectives.

Thank you.

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