North American Carbon Trading and Economic Integration

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- Political agreement will contain emissions reduction targets for developed countries and commitments to emissions reduction plans for developing countries. However, the agreement is not legally binding.
- The United States and Canada commit to a 17 percent reduction in greenhouse gases (GHG) from 2005 levels by 2020.
- Lack of a solid or detailed multilateral outcome could leave room open for regional coordination on climate change, especially for issues such as MRV[1] and REDD[2].

[1] Measuring, Reporting and Verification

[2] Reducing Emissions from Deforestation and Forest Degradation in Developing Countries

Will there be an integrated North American carbon regime?

- Probably not. Countries need to adjust their own programs to appease domestic constituencies and will not agree to give up sovereignty over their own climate policies.
- The United States will set its climate policy unilaterally, and Canada will likely create a system comparable to that of the United States.
- If a cap-and-trade system emerges, there might be some allowance trading between the United States and Canada. Mexico could be linked to the North American regime through offsets, not allowances.

North American Leaders' Summit
Guadalajara, Mexico, 2009

- Countries agreed to develop a Trilateral Working Plan for consideration in 2010 – but finessed the issue of how to reconcile GHG reductions with the need for energy security.
- 2009 Declaration on Climate Change and Clean Energy:
  - Green Fund
  - Comparable approaches to MRV
  - Collaboration on smart grid
  - Alignment of national energy efficiency standards
  - Reductions from oil and gas sectors
  - Cooperation on REDD.

Competitiveness provisions likely

- Rebates for trade-intensive, energy-intensive industries: Begin in 2012 in current legislation.
  - Issued on a product-output basis; cover 100 percent of *average* costs.
- International reserve allowance program: Could begin in 2020 in current legislation depending on international efforts to reduce emissions.
  - Imposed against imports from countries that fail to take comparable action on climate change.
  - Have already provoked outrage from developing countries.

US Regulation: Implications for North American Cooperation and Trade

- Under legislation currently under the table, in order for US firms to use allowances from foreign countries, the foreign country must have a national or international carbon trading regime that imposes mandatory absolute GHG emissions limits on one or more sectors and is at least as stringent as that of the United States.
  - Canada will comply only if it adopts absolute rather than intensity-based targets.
  - Mexico is unlikely to qualify in the near future.

US Regulation: Implications for North American Cooperation and Trade

- Offset sales could provide funding to help Mexico achieve its GHG reduction goals.
- However, restrictions apply.
  - Sectoral baselines must be set well below business as usual levels.
  - In order to sell REDD credits, Mexico must set a deforestation baseline that achieves net zero deforestation in 20 years.

US Regulation: Implications for North American Cooperation and Trade

- There is uncertainty surrounding the future of existing state-provincial cap-and-trade compacts.
  - Under current US cap-and-trade legislation, multi-jurisdictional cap-and-trade agreements among US states and Canadian provinces – including the RGGI[1], WCI[2], and Midwest Accord cap-and-trade systems – will have to be disbanded.
  - While holders of allowances issued by US states will receive federal allowances to compensate, Canadian holders of allowances under the WCI will not. It is yet unclear how the disbanding of the multi-jurisdictional trading system will affect carbon markets in participating Canadian provinces.

[1] Regional Greenhouse Gas Initiative
[2] Western Climate Initiative

Renewable energy

- It is still unclear whether electricity exported across borders will count as eligible renewable energy under a federal US renewable portfolio standard.
  - In the Waxman-Markey bill, hydroelectricity exported from Canada to the United States will subtract from a utility's generation baseline, making it easier for utilities to meet the renewable portfolio standard – but regulatory difficulties could prevent Canadian hydropower itself from counting as a renewable source.

US Regulation: Implications for North American Cooperation and Trade

- If Congress does not act, the EPA is obligated to step in and regulate.
- Proposed EPA rule will require large facilities to adopt the best available GHG emissions reduction technology when their facilities are constructed or upgraded.
  - Would cover about 400 new facilities and modifications per year.
- Sectors with a high degree of intra-industry trade between the United States and Canada that are likely to be required to obtain permits under the program include paper, petrochemicals, basic organic and inorganic chemicals, plastics, resins, iron, and steel.

A New NAFTA "Overlay" for Energy and Climate Change

- Use the Commission for Environmental Cooperation (CEC) as a clearinghouse for climate change-related data.
  - Expansion of database on North American emissions.
  - Reporting on new climate initiatives and regulations in each country.
  - Clearinghouse for monitoring, reporting, and verification (MRV) of carbon credits issued under national or regional carbon regimes.

- Standardize definitions of renewable energy and coordinate renewable energy policies.
  - Both Canada and the United States should agree on how imported electricity – particularly hydro – should be credited and certified under renewable portfolio standards. Border states and provinces should continue to work toward zero-carbon energy generation through existing regional institutions.

A New NAFTA "Overlay" for Energy and Climate Change

- Adopt a NAFTA peace clause.
  - "Carbon protectionism" in the near term is likely to be emulated or provoke retaliation in other countries.
  - A framework needs to be developed under the WTO to handle competitiveness concerns that are not addressed through international climate negotiations.
  - A temporary "peace clause" suspending border measures for a limited time should be incorporated into climate legislation in order to encourage WTO negotiating efforts.
  - Liberalization of environmental goods and services should be given higher priority in the Doha negotiations.

- Establish a "safe harbor" to shield climate change taxes and regulations from claims under the indirect takings provisions of NAFTA Chapter 11.
  - Chapter 11 requires governments to provide compensation to investors for measures that are "tantamount to expropriation."
  - To date, Chapter 11 cases have assumed a limited scope for environmental laws' constituting expropriation – but climate change laws will have unprecedented economic effects.
  - If not clarified, Chapter 11 could provoke regulatory chill and adversely affect trade and investment flows in the region.

A New NAFTA "Overlay" for Energy and Climate Change

- Promote capacity building in Mexico.
  - Capacity building in Mexico will be essential to North American coordination.
  - NAFTA facilitation of Mexican carbon offset sales could potentially help bridge the funding gap between Mexico and its northern neighbors.
    - Emissions will have to be reduced below business-as-usual levels in order for Mexico to obtain offset credits.
  - The North American Development Bank (NADB) should be used to provide finance and technical assistance for energy-saving and pollution control projects in Mexico.