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Response Report to Canada's Proposed Regulatory Framework for GHG Emissions from Oil and Gas

CSL White Paper

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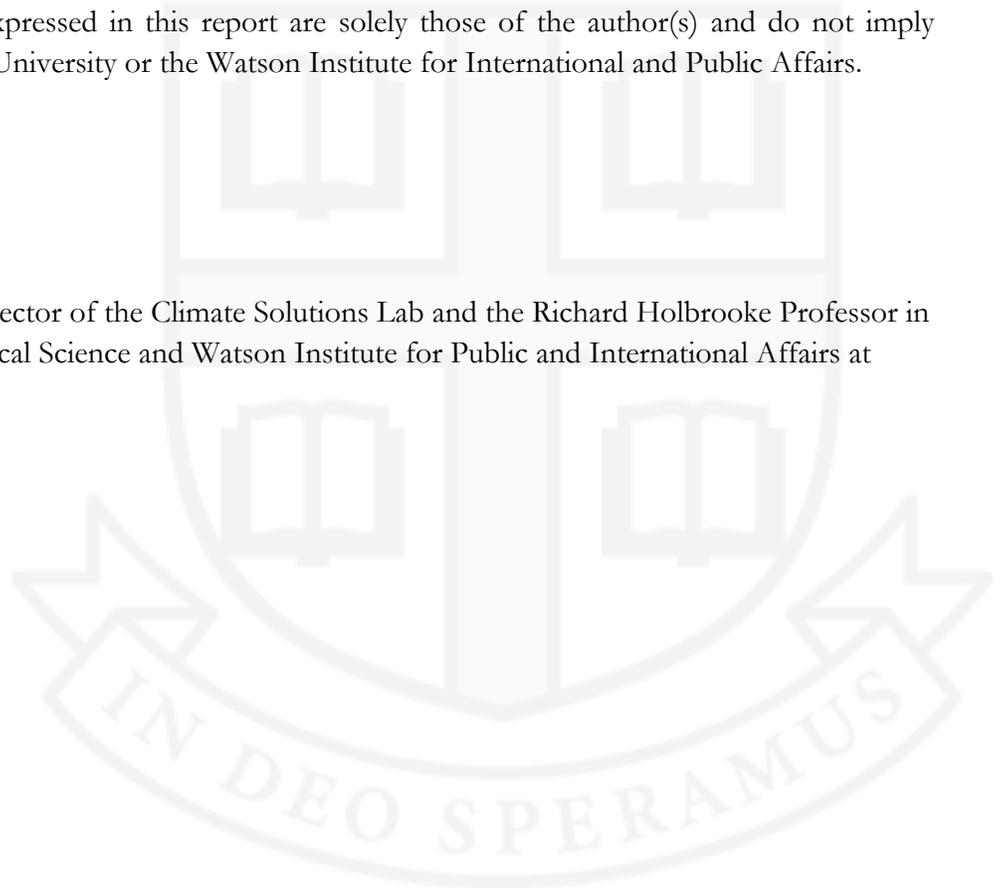
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The Government of Canada has issued a proposed [Regulatory Framework](#) for greenhouse gas (GHG) emissions from the oil and gas sector, and invited public comment on the Framework by February 2024. This Climate Solutions Lab (CSL) report, based on input from experts at Brown University and the University of Toronto, provides suggestions to improve the effectiveness, credibility, and administrative simplicity of the Regulatory Framework, without any sacrifice to political feasibility.

We note with disappointment the Government of Canada's backtracking on its own climate goals. The Regulatory Framework proposes a set of GHG reduction targets for the Oil and Gas sector that is significantly smaller than what the Government had previously proposed. In addition, the Government's plans do not put Canada on track to meet its goals under the 2015 Paris Agreement on climate change. Failing to hold the oil and gas sector accountable for its share of Canada's emissions reductions required by the Paris Agreement means that every other sector of Canada's economy will have to do more to meet the Paris targets. Nonetheless, our recommendations accept the Framework's emissions target as is, and seeks to improve the mechanisms by which that target is achieved.

We also note some positive features of the Framework. It identifies a specific, quantitative target for the sector's absolute GHG emissions, not just emissions intensity. The Government's targets align with what the Canadian oil and gas industry has previously announced publicly that it would do voluntarily, which essentially makes this Framework a credibility mechanism to ensure action. And we appreciate that the Framework can be implemented with a minimal cost to the Canadian economy; indeed, it seems likely to improve Canada's economic competitiveness over time.

Still, our summary view is that the existing Framework creates too many loopholes for industry to avoid making real reductions to GHG emissions. It is also too complex. The Climate Solutions Lab makes **four specific recommendations** about the Government of Canada's proposed Framework: 1. Eliminate the Use of ITMO Credits, 2. Set a Floor for Enforcement Penalties, 3. Simplify the Framework, and 4. Contribute to a Long-Term Vision for a Sustainable Net-Zero Economy. These recommendations are designed to improve the simplicity, credibility, and effectiveness of the Framework, while managing political trade-offs.

1. Eliminate the Use of ITMO Credits

The Framework states the Government is considering the use of international carbon offset credits called "Internationally Transferred Mitigation Outcomes," or ITMOs. The decision to allow ITMOs presumably depends on various trade-offs, including environmental benefits, simplicity of regulation, and political expediency. While designing the Framework often confronts the Government with difficult trade-offs, in this case the choice is easy: the downsides of ITMOs far outweigh the benefits.

The environmental record of international carbon offset credits is very poor. To offer real benefits, international projects have to offer additionality (that is, make changes that wouldn't have happened otherwise) and remove GHG permanently. A mountain of academic research shows that most carbon offset programs do not live up to these standards.¹ Corruption is a significant problem, especially in some developing countries. In other countries, the more common problem is the money being used to fund projects that would have happened anyway. The Clean Development Mechanism set up under the Kyoto Protocol, for instance, transferred hundreds of millions of dollars to China and other developing countries without producing much environmental benefit.² Linking domestic carbon markets to international ones often weakens the environmental benefits.³

Carbon credits based on forests (or avoided deforestation) are especially terrible. The basic problem is that carbon pollution is forever, but forest carbon storage is not. Forest fires, for instance, can wipe out the trees planted to capture carbon dioxide. When CO₂ is emitted, it is gradually re-absorbed by forests and oceans, but even after 1,000 years about 25% of the original mass remains aloft. Carbon credits based on forests, by contrast, typically last only 1 to 100 years, despite promises of permanence. “The most well-known carbon offsets come from efforts that claim to prevent tropical deforestation, where projects typically claim to protect and monitor forests for about 40 years.”⁴ The IPCC expects this problem to grow worse as climate change causes more forest fires in the future.⁵

There is every reason to expect ITMOs allowed under the Paris Agreement to continue the poor environmental record of early carbon offsets schemes. Hope springs eternal about these schemes because polluting industries are always looking for a cheap way to gain permits for their emissions and have little incentive to care about the actual environmental benefits. The truth is that a carbon offset market that actually reduced GHG in the atmosphere permanently would be highly expensive and complex.

If ITMOs are allowed under the Framework, it would also add to complexity. Businesses would need to show that they had obtained credible ITMOs, and regulators would need to verify them. While some businesses might appreciate having another option for complying with the framework, putting more options on the table creates more complexity for the Framework overall, because each option comes with short-term and long-term costs and risks. ITMOs, in

¹ Cullenward, Danny, Grayson Badgley, and Freya Chay. 2023. “Carbon Offsets Are Incompatible with the Paris Agreement.” *One Earth* 6(9): 1085–88; West, Thales A. P. et al. 2023. “Action Needed to Make Carbon Offsets from Forest Conservation Work for Climate Change Mitigation.” *Science* 381(6660): 873–77.

² Schneider, Lambert. 2009. “Assessing the Additionality of CDM Projects: Practical Experiences and Lessons Learned.” *Climate Policy* 9(3): 242–54; Calel, Raphael, Jonathan Colmer, Antoine Dechezleprêtre, and Matthieu Glachant. 2021. “Do Carbon Offsets Offset Carbon?” <https://papers.ssrn.com/abstract=3950103> (December 15, 2023).

³ Green, Jessica F. 2017. “Don’t Link Carbon Markets.” *Nature* 543(7646): 484–86.

⁴ Cullenward, Danny. 2023. <https://kleinmanenergy.upenn.edu/news-insights/why-temporary-carbon-storage-in-forests-has-little-climate-value-part-1/>

⁵ See <https://www.ipcc.ch/report/ar6/wg1/chapter/chapter-11/>, 11.8.3

particular, might be cheap in the short term but expose the businesses that use them to accusations of greenwashing and long-term reputational or legal risks.

Given that ITMOs are environmentally unfriendly and increase the complexity of the Framework, the only reason the Government would consider them rests upon political expediency. Allowing ITMOs might marginally reduce the oil and gas industry's resistance to the Framework. This factor is overwhelmed, however, by other political considerations. Any political benefit from ITMOs is small: *the constituency for sending Canadian dollars overseas to pay for environmentally dubious projects cannot be large*. Not many Canadian voters would actually want ITMOs as part of this policy. Moreover, the Government (and governing political party) that allows ITMOs will eventually face public accountability for the environmental results, which are likely to be poor. The only reason to allow ITMOs is the weak hope of muting industry criticism of the Framework. In reality, the oil and gas industry's position is unlikely to be much affected by the ITMO provisions, and if the Framework cannot be adopted without ITMOs, allowing ITMOs is unlikely to make the difference.

2. Set a Floor for Enforcement Penalties

The Framework is vague and mostly silent about the penalties that industry should expect for exceeding the Legal Upper Bound on emissions. It provides slightly more detail about what to expect for the costs of "Compliance Flexibility Units," which it says, "could be around \$50 per tonne CO₂e." (The Compliance Flexibility Units can be used for any emissions above the Emissions Cap but below the Legal Upper Bound.) A crucial outstanding question, then, is what the *de facto* costs of exceeding the Legal Upper Bound would be.

Enforcement credibility and costs are essential for shaping the industry's expectations. Academic research shows that the lack of policy credibility has significantly hurt progress on the clean energy transition and reducing emissions.⁶ In principle, the costs of exceeding the Legal Upper Bound should be considerably higher than the Compliance Flexibility Units, for multiple reasons. One reason is the legal and moral imperative that there ought to be costs to breaking the law. A second, more pragmatic, reason is that enforcement imposes costs on the Government, in terms of monitoring behavior to check for compliance, deciding how to react to suspected violations, and the costs of actually collecting any fines and/or imposing penalties.

Consequently, The CSL recommends that the Framework specify a minimum financial penalty (a floor) of three times (3x) the cost of Compliance Flexibility Units to guide industry expectations about the cost of violating the Legal Upper Bound. To be clear, this minimum financial penalty would not prevent the government from imposing stiffer financial penalties or taking non-financial actions, including legal efforts to end operations of facilities in non-compliance.

⁶ Gazmararian, Alexander F., and Dustin Tingley. 2023. *Uncertain Futures: How to Unlock the Climate Impasse*. Cambridge University Press.

3. Simplify the Framework

The Framework will work best for both Government and the oil and gas industry if it is relatively simple, to increase the efficiency of compliance. Against this desire for simplicity, the Government must weigh the industry's desire for flexibility. The danger of allowing too much flexibility, however, is that the Framework can become a victim of logrolling. Each time the Government adds a provision to account for the needs of specific businesses, it creates additional complexity. The risk is that the net result is a policy that is more complicated and less efficient than anyone wants.

The Framework could be made simpler and better by doing the following:

1. **Eliminate “Banking.”** The Framework already allows for a multiyear compliance period, meaning that facilities would have three-year windows to accomplish their GHG reductions. The proposal to allow facilities “to bank allowances for up to two compliance periods (six years)” needlessly complicates the implementation and enforcement Framework. It is an invitation to industry to try to game the system instead of actually reducing their emissions in a consistent fashion, year after year.
2. **Clarify the scope.** The Framework says that it covers “bitumen and other crude oil production, including upstream oil gathering pipelines when they are part of a covered facility, — other than bitumen extracted from surface mining and other than petroleum refining,” which suggests that surface mining is not covered. But the next bullet point says that it covers “surface mining of oil sands and extraction of bitumen.” This language should be polished and clear.
3. **Make use of public monitoring.** The Framework states, “All covered facilities would be required to submit annual reports, including reporting facility GHG emissions and production, and indirect GHG emissions” and that “The reports would need to be verified by a third party that meets the requirements set out in the regulations.” These are sensible requirements, but the Framework could simplify and strengthen the reporting of GHG emissions by explicitly inviting public scrutiny of the corporate claims by civil society. New satellite and remote sensing technologies now allow these emissions to be monitored by NGOs, and the Government should take advantage of these technologies.
4. **Clarify how small facilities will be treated.** Per the framework there are “numerous small facilities that together account for 30% emissions.” The definition of small facilities is on the one hand clear (facilities with GHG emissions below 10 kt CO₂e per year) but also raises questions, such as: how is one small facility delineated from an adjacent facility? How is facility ownership taken into account? Excluding small facilities incentivizes creating multiple new small facilities or subdividing existing facilities. We recommend a phased approach based on facility ownership: initially include those small facilities wholly- or part-owned by companies that are already subject to the regulation; later, include small facilities independently owned or owned by companies not otherwise covered by the regulation.

4. Contribute to a Long-Term Vision for a Sustainable Net-Zero Economy

Any serious plan for a clean energy transition must explicitly address two key challenges. In the short- and medium-term, the world needs oil and gas and Canada's industry has a role to play in supplying those needs. Thus, the first challenge is to reduce domestic emissions related to an internationally traded commodity. This means holding industry to account while also supporting (or not undermining) its competitive position. The second challenge is to respond to a long-term global phase down of the oil and gas industry while minimizing any negative economic consequences for Canada and especially its Western provinces. Ideally, this response should involve generating new opportunities for prosperity. This second challenge requires an industrial policy that creates jobs and prosperity in the new, cleaner energy sector of the future.

In other words, regulations and emissions reduction plans must be developed in tandem with industrial strategy that matches a long-term global transition to clean energy. Policy coherence in this space is a must. While a comprehensive, long-term vision for the clean energy transition in Canada is outside the scope of the Framework, the Framework can and should contribute to that vision.

We recommend the Framework offer some broad indications of how the proposed Decarbonization Fund would generate alternative jobs and sources of prosperity in the long run. At present, the Framework does not connect with other Government policies, like the [Sustainable Jobs Plan](#), the [Smart Renewable and Electrification Pathways Program](#), or the [Low Carbon Economy Fund](#). It barely mentions jobs at all. Failing to specify how the Decarbonization Fund will support the economic future of oil and gas producing regions, like Alberta, Saskatchewan, and the Atlantic provinces, creates unnecessary opposition and contributes to regional disputes that could stall future action.

As currently proposed, the Decarbonization Fund would be used for facility-level oil and gas emissions reductions, which keeps the money within the oil and gas sector rather than generating long-term alternatives to it. In practice, this Fund likely means funnelling money back into the oil and gas sector for carbon capture, utilization, and storage (CCUS). Since the government co-finances CCUS projects and already has a generous tax credit that provides [double the subsidy](#) provided by the Inflation Reduction Act in the United States,⁷ the Decarbonization Fund risks becoming yet another CCUS subsidy for the oil and gas sector, and without the stringency applied to domestic offset credits (emphasized as “real, additional, quantified, verified, permanent, and unique GHG emissions reductions”). The Decarbonization Fund should not be a vehicle for the oil and gas industry to avoid making cuts to emissions while simply recycling money back to itself.

One central question for the clean energy transition is how to provide incentives for workers, particularly young workers, to choose career paths in industries outside of the fossil fuel industry. Gradually channelling workers away from the fossil fuel industry is compatible with a phase down of fossil fuels in Canada while preserving the country's economic prosperity. Doing

⁷ Carter, Angela and Laura Cameron, 2023. “Why Carbon Capture and Storage Is Not a Net-Zero Solution for Canada's Oil and Gas Sector,” IISD. <https://www.iisd.org/articles/deep-dive/carbon-capture-not-net-zero-solution>

so would also reduce the size and political power of the fossil fuel industry, which is a necessary step in creating further pro-climate policies in the future.

Currently, wages in the fossil fuel industry are often higher than the alternatives, especially for entry-level workers. The Decarbonization Fund could be used to fund training and skill development, or wage subsidization in clean energy technologies, or perhaps in some other ways to generate those incentives. It could be a standalone program, but to save administrative overhead, the money simply could be added to one of the existing government programs for a clean energy future. The Framework does not need to spell out all the details of how the Decarbonization Fund would work but should make it clear how it would benefit Canadian workers that want a just and equitable transition over time.

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We appreciate the Government of Canada's proposed [Regulatory Framework](#) as a step forward in reducing greenhouse gas (GHG) emissions from the oil and gas sector. We hope the Government will use our four recommendations to improve the effectiveness, credibility, and simplicity of the Regulatory Framework. There is no public policy goal more important in the 21st century than meeting the threats to the sustainability of our planet's global environment.