Climate Conditions on Government Spending Programs

BRIEFING NOTE
June 2021

environmental defence

This briefing note sets out decision-making parameters, government responsibilities and funding conditions that should be built into funding programs aimed at industrial decarbonization.

In order for Canada to do its fair share under the Paris Agreement and limit global temperature increase to 1.5 °C, economy-wide rapid decarbonization is necessary. Ultimately, Canada's path to zero emissions will be defined by policy choices. The path we take is a societal choice, with significant implications for intergenerational equity, social and economic justice, land use rights, access to energy, sustainable development, and our ultimate effectiveness in decarbonising our economies and aligning with a 1.5 °C future.

The necessary total transformation of our current industrial systems away from fossil fuels to renewable, non-emitting systems will require significant levels of public and private investment. The federal government of Canada has developed several new funding programs designed to facilitate rapid decarbonization and accelerate industrial transformation. Though the focus of the recommendations provided in this briefing note are for those programs, specifically the Net Zero Accelerator fund, the Propelling Clean Tech projects fund and the Low-Carbon and Zero-Emissions Fuels fund, many of the recommendations are also applicable to other funding programs (including funding provided through Natural Resources Canada, Sustainable Development Technology Fund, Trade Corridors Fund, Green Bond program, Low-Carbon Fuel Procurement program, etc), as well as new taxation instruments (tax incentive for CCUS, tax deduction for zero-emission technology manufacturing, capital cost allowances, etc.).

Alongside these financial tools, it is critical that the federal government develop a decarbonization pathway, an industrial policy framework and sectoral carbon budgets. These should be aligned with the IEA's recent Net Zero by 2050 Roadmap for the Global Energy Sector, which maps out how the global energy sector can reach net zero emissions by 2050 and contains critical milestones that should be incorporated into Canadian policy.

It is equally critical that funding does not lock Canada's industries into continued dependence on fossil fuels or violate Canada's commitment to eliminating fossil fuel subsidies. Environmental Defence is concerned that an unrealistic overreliance on carbon removal will preserve the status quo and risks distracting and diverting resources from the need to take concerted action across multiple sectors in the near-term to dramatically reduce emissions. The pathway presented by the IEA achieves its objectives with no offsets from outside the energy sector and with low reliance on negative emissions technologies. Similarly, the Canadian Institute for Climate Choices (CICC) warns that if Canada relies too heavily on engineered forms of negative emissions technology that fail to prove viable, it could significantly increase the costs of reaching our climate commitments, or cause us to miss these targets altogether. Both the IEA and the CICC recommend that countries seize upon currently available, affordable and sustainable solutions that will do most of the heavy lifting to achieve deep reductions in the next decade. Environmental

Defence strongly opposes any effort to promote carbon capture as an alternative to stringent absolute emission reductions.

Program Design

In the absence of industrial decarbonisation policy and a clear strategic vision, the new funding programs require thoughtful design to ensure that the funds are being used effectively and efficiently (for example, from a cost per tonne lens) to drive rapid, deep and sustained emissions reductions aligned with the goal of achieving zero emissions. This analysis should include assessing whether different policy tools (mandates, standards, targets, regulations, carbon pricing, etc) could more effectively and efficiently achieve decarbonization outcomes in various sectors. There should be an assessment of how much of the funding will go to the proven solutions that need to be widely scaled up in the next decade (for example, electrification and energy efficiency in industrial processes and renewable energy production) and how much should instead support emerging technologies that will be important post-2030 but are not yet economical on their own (for example, electrolysers and advanced batteries). The "safe bets" and "wildcards" approach provided by CICC is a helpful framework for this type of analysis. The CICC warns that wild-cards should be handled with careful attention to risk and uncertainty, as they could jeopardize Canada's net zero efforts.

In addition to these considerations, it is imperative that the federal government attach robust conditions to the distribution of funds (outlined below), and ensure that there is capacity to monitor and enforce these conditions

Parameters for Government Decision-Making

- All government spending should align with Canada's obligations under the Paris Agreement to do our fair share to limit global temperature increase to 1.5 °C. The IEA's Net Zero by 2050 Roadmap provides a useful tool for assessing whether projects align with the Paris Agreement or not.
- Support should not be provided for projects and industries that are clearly incompatible with a 1.5 °C trajectory and/or result in carbon lock-in (this includes all fossil fuels, including blue hydrogen, or technologies aimed at extending the use of fossil fuels, such as CCS in the oil and gas sector or CCS-EOR or end-uses for natural gas).
- Funding should not be provided to projects where the emissions abatement relies on offsets or where emissions reductions come from assumptions about avoided or displaced emissions. Similarly, funding should not be provided for projects that rely on uncertain assumptions of future or scale-up negative emissions technologies as a substitute for direct emissions reductions. In other words, there is no justification to provide funding that will delay direct emissions reductions by betting on future negative emissions technologies.
- The rationale and criteria for funding decisions should be made public. This should include an overall assessment of how the funding program aligns with Canada's decarbonization pathways. At a project specific level, there should be transparent assessments of whether providing funding is the most efficient and effective way to achieve intended outcomes and an examination of alternative approaches.

- An assessment must be conducted to determine the risk of projects becoming stranded assets as a result of the global push toward decarbonization. For example, through an assessment of global demand for an export product in a 1.5°C scenario.
- As much as possible, funding should be in the form of repayable loans and not grants. If grants are used instead, and the intended outcomes are not achieved, companies should be obligated to pay back the entire amount.
- Proponents must show that government funding is a necessary condition for the execution of the project. Similarly, proponents must demonstrate that the amounts of funding requested are necessary to span the internal rate of return gap. This is to ensure that the government is not simply subsidizing projects that are already commercially viable and would happen without funding. For certain programs it would be prudent to establish a limit on what percentage of overall project funding can come from government.
- In addition to emissions reductions, government support should prioritize:
    - Projects led by Indigenos communities or businesses.
    - Early, deep and sustained direct emissions reductions that are compatible with action to achieve zero emissions outcomes in a sector.
    - Projects that reduce dependence on fossil fuels.
    - Projects that address social, racial and economic inequities.
    - Projects that use best available technologies.
    - Projects with the highest job creation per dollar invested.
- To ensure funding is available to small and medium sized companies, the $10 million lower limit on funding should be removed

Government Responsibilities

- Monitoring and enforcing of conditions: Enforcement of conditions for funding is crucial but has often been neglected. Companies who have received funding with conditions must have clear and measurable indicators and reporting requirements. Adequate departmental capacity must be made available for this, and appropriate tools and benchmarks must be developed. If companies do not follow funding conditions, financial or otherwise, the government should consider applying penalties or provisions to convert the type of aid provided.
- Transparent and timely reporting of all support provided: This should include the exact amount and type of each transaction, the purpose of the funding, expected GHG emission reductions and accounting of the associated full lifecycle emissions. The conditions tied to funding must also be made publicly available and regular updates should be provided to the public on whether conditions are being met.
- Annual evaluation of the funding programs: Evaluations should determine impact on emissions and other key benchmarks and assess whether the program is achieving its intended objectives and incentivizing the types of projects aimed for. If these evaluations demonstrate that corrective actions are required, these should be carried out in a timely manner. These evaluations should be made publicly available.

Conditions on Proponents:

- Companies must develop plans to align their operations with Canada's commitment to limit global temperature increase to 1.5 °C. These plans must: include scope 1,2,3 emissions; contain ambitious 5-year interim targets; not rely on offsets or unproven negative emissions technologies, and instead prioritize absolute, deep and sustained

direct emissions reductions. The plans must be made publicly available. Companies should be required to produce yearly reporting on their progress towards achieving their targets. The IEA’s net-zero by 2050 roadmap is a useful tool for assessing climate plans.
- Companies that receive stimulus funding must carry out robust climate risk disclosure, at minimum the reporting framework of the Task Force on Climate-related Financial Disclosures.
- Companies must be required to submit regular reports on use of funds to ensure compliance with all conditions.

These recommendations are complementary to those proposed by the International Institute for Sustainable Development in their report: “Green Strings: Principles and conditions for a green recovery from Covid-19 in Canada”.