



Saskatchewan Chamber of Commerce Briefing Note

Revised September 2017

Summary and Analysis of Environment and Climate Change Canada (ECCC) Technical Paper on Federal Carbon Pricing Backstop

Background

In December 2016, the Government of Canada, along with most of the provinces and territories agreed to the *Pan-Canadian Framework on Clean Growth and Climate Change* to meet national greenhouse gas (GHG) emissions reductions targets. A central component of the Pan-Canadian Framework is pricing emissions across Canada. The Pan-Canadian Framework indicates that all provinces must have their own carbon pricing mechanism in place by 2018 or else the federal backstop plan will be imposed on those provinces that do not have one in place.

According to the Federal Government, pricing carbon emissions is recognized as the most efficient way to reduce GHG emissions, incent investments in low-carbon technologies, and encourage households and businesses to conserve energy. The Federal Government believes the use of price signals will incent desirable economic behavior and reduce GHG emissions at the lowest possible cost to businesses and consumers. The Government of Saskatchewan continues to disagree with this position. Premier Brad Wall has refused to sign on to the framework and has even threatened legal action if the Federal Government imposes carbon pricing on Saskatchewan.

The Technical Paper on the Federal Carbon Pricing Backstop was released on May 18, 2017 and seeks to inform Canadians and industry stakeholders about the plan, as well as obtain feedback on its design.

Pan-Canadian Framework

Carbon pricing systems across Canada need to meet the following criteria:

- Be introduced in a timely manner to ensure that carbon prices applies to main sources of GHGs in Canada starting 2018.
- It needs to be applied to the sources of GHG emission across country to ensure that it is both effective and fair.
- Provinces can choose to implement either:

- A direct pricing regime such as the BC carbon tax, or a carbon levy combined with an output-based emissions regime similar to Alberta, or;
- A cap and trade mechanism on emissions, as is used in Ontario and Quebec.
- Stringency of carbon pricing needs to increase over time and should be enshrined in legislation to ensure certainty for businesses and consumers.
- For jurisdictions with an explicit price-based system, a carbon price starts at a minimum of \$10 per tonne and rises by \$10 per year to \$50 in 2022.
- Provinces with a cap and trade regime are to have:
 - 2030 emission reductions targets equal to or greater than the Federal Government's 30% reduction target.
 - Declining and more stringent emission caps to at least 2022 that correspond with the minimum projected emissions reductions that would have otherwise resulted from applying a direct carbon price during the year in question (i.e. reductions that would have resulted from \$10 per tonne in 2018).
 - Jurisdictions must provide regular, transparent, and verifiable reports on outcomes and impacts of their carbon pricing policies.

Federal Carbon Pricing Backstop

The Federal Government's backstop plan will be imposed on jurisdictions that do not already have a carbon pricing system in place or will be used to top up existing carbon pricing systems that do not fully meet the federal benchmark. As of May 2017, the vast majority of Canadians live in provinces that already have a price on carbon pollution or are working toward implementing one. Manitoba recently signaled their intent to implement their own carbon pricing regime and are currently in the process of developing a Made-in-Manitoba solution. The federal backstop will return direct revenues from the carbon price to the jurisdiction of origin. The federal backstop does not offer as much room for flexibility as a carbon pricing plan that would otherwise be designed for a province's particular economic circumstances in mind. The proposed backstop plan is the hybrid approach currently being implemented in Alberta that is composed of two key elements:

- A Carbon Levy applied to an array of fossil fuels
 - The start date for the Carbon Levy was originally supposed to be Jan. 1, 2018 but over the course of discussions with technical experts at ECCC, they have softened their deadline for a yet-to-be determined date in 2018. Officials at ECCC emphasized that while timelines are important, they want to "get this right."
- An Output-Based Pricing System for large industrial facilities that emit above a certain threshold (50 kt of CO₂e per year) with an opt-in capability for smaller facilities with emissions below that threshold¹
 - Similar to the softening of the implementation date for the Carbon Levy as described above, officials at ECCC have softened their original date of

¹ Note: CO₂e refers to "carbon dioxide equivalents" and is a standard unit of measurement for carbon emissions. Because GHGs go beyond simply just CO₂ and each GHG has a different Global Warming Potential (GWP), all GHG emissions are converted into "CO₂ equivalents" so they can be compared.

Jan. 1, 2019 to just sometime in 2019. ECCC is still in the process of finalizing some outstanding issues related to the Output-Based Pricing system.

Carbon Levy

- Fossil fuels subject to the carbon levy include:
 - Liquid fuels (petrol, diesel, aviation, methanol, naphtha, petroleum coke)
 - Gaseous fuels (natural gas, propane, butane, ethane, still gas, pentanes plus, coke oven gas)
 - Solid fuels (coal, coke, waste fuel, tires)
- Generally, the levy will apply to fuels that are used in a backstop jurisdiction, irrespective of whether the fuels were produced in, or brought into, that jurisdiction. The levy applies to fuel that is combusted, vented, or flared. Fuels that do not produce heat or energy will not be subject to levy.
- In *most* cases, the levy will be applied early in the supply chain for each type of fuel used and will be payable by the producer or distributor. The end-user will *generally* not have any obligations in respect to the levy, as fuel being purchased by the end-user is already levy-paid in *most* cases. However, the costs to end-users will likely increase due to the higher costs for suppliers.
- The four categories of entities within the fuel supply chain for the purposes of the levy include:
 - *Registered Fuel Distributors* (producers of fuel, large wholesalers, oil refineries, coal mine operators, natural gas retailers)
 - *Registered Fuel Importers* (entities outside Canada who import fuel into a backstop jurisdiction or bring fuel from another province)
 - *Registered Fuel Users* (users required to report on fuel used in a backstop jurisdiction, and possibly pay levy or claim relief from levy where it has been previously paid)
 - *Non-Registered Persons* (generally retailers other than natural gas retailers and individuals and businesses)
- If a non-registered person imports fuel at a location in a backstop jurisdiction, the person will report directly to the Canada Border Service Agency (CBSA) upon importation and remit the levy to the Receiver General of Canada.
- A person that imports less than 200 litres will generally not have to register as a fuel distributor.
- Relief from the carbon levy will be provided under the following circumstances:
 - Fuel used at a facility whose emissions are accounted for under the output-based pricing system
 - Gasoline and Diesel fuel inputs used by registered farms in specified agricultural activities
 - Fuel exported or removed from backstop jurisdiction
 - Fuel used as international ship stores (international aviation and marine fuels)
 - Fuel purchased by visiting military forces or diplomats
 - Fuel in sealed, pre-packaged containers of one litre or less
 - Biofuel portion of blended fuels

- The Federal government will develop a mechanism for providing levy relief (exemption certificates, rebates, etc.) in the future.
- The introduction of carbon pricing in all Canadian provinces and territories will now cover aviation fuels for inter-jurisdictional flights in Canada in the future to ensure a consistent national approach. The present exemption on aviation fuels was made to address competitiveness concerns for local airports but will be phased out.

Output-Based Pricing System

- The purpose of an output-based pricing system is to minimize competitiveness issues and carbon leakage risks for activities for which those risks that are high, while retaining the incentives to reduce emissions created by the pricing mechanisms.²
- The output-based pricing system will apply to industrial facilities that emit 50 kt or more of CO₂e per year. Exempted sectors include buildings (municipal, hospitals commercial, schools, universities), as well as waste and wastewater facilities, regardless of emissions levels.
- Facilities in industrial sectors that emit less than 50 kt of CO₂e per year will have ability to opt-in to this system. This offers flexibility for smaller industrial facilities to pay the carbon levy or fulfill the requirements to participate in the output-based pricing system. This discourages the perverse incentive for smaller facilities to intentionally emit more GHGs in order to be eligible for treatment under the output-based pricing system.
- To determine a facility's emissions allotment, the annual GHG emissions limit will be the sum of the emissions limits for all activities that the facility undertakes:
 - i.e. Annual Facility Emissions Limit (tons of CO₂e) = output-based standard (tons of CO₂e/unit) x units produced³
- If an industrial facility emits *less* than its annual emissions allotment, it will receive *surplus credits* from the Federal Government for the *difference* between its limit and what was actually reported. Each surplus credit represents one ton of CO₂e. Surplus credits may be banked for future use (possible restrictions on number of years coming soon) or traded to another participant.
- *Carbon offset credits* can be obtained from voluntary activities such as those not subject to GHG emissions regulations, not required by law, and not supported by government financing.
- If an industrial facility *exceeds* its annual emissions allotment, the options available to emitters to meet its compliance obligations include:
 - Payment to the Federal Government of the carbon price contained in the backstop legislation and the federal benchmark for the reporting year
 - Use of eligible carbon offset credits

² Note: Carbon leakage is a situation where as a result of stringent environmental regulations, companies move production over to jurisdictions with less stringent environmental regulations. This can lead to either no net change in global GHG emissions or even worse, a net *increase* in global GHG emissions.

³ Note: An output-based standard is an emissions-intensity standard (i.e. tons of CO₂e per megawatt hour of electricity). The output-based standard will be set by a level that represents best-in-class performance (top quartile or better) in order to drive reduced emissions intensity.

- Use of surplus credits issues by the Federal Government to facilities that emitted *less* than their allotment
- Reporting and verification at the end of each compliance year is required to quantify emissions using prescribed methodologies. Reports will be verified by a third-party to ensure a reasonable level of accuracy. Independently verified reports must be submitted to ECCC by March 31st following the calendar year of compliance.

Analysis

Impact on Energy-Intense and Trade-Exposed (EITE) Industries

- The output-based pricing system for industrial sectors that emit more than 50 kt of CO₂e per year creates additional costs, challenges, and uncertainty for Saskatchewan's resource-based energy intense and trade-exposed sectors who are unable to pass along the additional costs (both direct and indirect) of carbon pricing to consumers.
- For those large industrial emitters operating at or near "best-in-class" in terms of mitigating their GHG emissions, those companies at least theoretically, will be much better prepared for if and when a carbon pricing regime comes into effect. For those large industrial emitters that are not doing all they can reasonably do compared to similar companies operating in similar environments, the carbon price will be much more financially punitive.
- While many larger emitting members continue to operate at or near "best-in-class" technologies, there are certain kinds of industrial processes, like melting steel in a furnace that require a theoretical minimum amount of energy to be used. In such circumstances, there is very little opportunity in reducing carbon emissions or conserving energy. Policymakers at Environment and Climate Change Canada developing the federal carbon pricing backstop plan need to be made aware of this reality.
- Because there is a gap between when the Carbon levy will be introduced (2018) and when the Output-Based Pricing System will be introduced (2019), EITE industries and other heavy emitters that would otherwise fall under the purview of the Output-Based Pricing System in the meantime would be subject to the Carbon Levy instead.
- Some uncertainty remains as to whether or not threshold for output-based pricing system for industrial facilities might be lowered from 50 kt of CO₂e per year to 10 kt of CO₂e per year in the future, given the proposed changes tabled by ECCC to the separate Greenhouse Gas Reporting Program (GHGRP). If so, this means that more industrial emitters might fall under the authority of the output-based pricing mechanism in the future.

Recycling of Carbon Revenues

- While revenues from carbon pricing will stay in the province, the Federal Government is non-committal about whether or not revenues will be given directly to the province for distribution or if the Federal Government will just bypass the province altogether and distribute revenues directly to businesses and households.

- In recent discussions with the Federal Government, officials at ECCC confirmed that GST (5%) would be charged on any carbon pricing mechanism as outlined in the federal backstop. Essentially it is a “tax on a tax” as there is no way in which to exempt the GST on carbon pricing. Still undecided is whether or not the Federal Government will administer the collection of the GST and skim their own administrative costs off the top and remit the net revenue back to the province.
- The Federal Government’s ability to generate revenue off of carbon pricing through the inclusion of GST contradicts Prime Minister Trudeau and Minister McKenna’s earlier assurance that Ottawa would not collect any revenue from carbon pricing.
- The provision under the carbon levy that Registered Fuel Users be required to file monthly returns to the Canada Revenue Agency (CRA) is an undue and unnecessary administrative burden on those required to remit.

Opportunities for Carbon Offsets and Credits

- The Chamber should explore and promote opportunities for certain sectors to earn carbon offset credits for environmentally beneficial activities such as zero-tillage and crop rotation in farming, electricity generation via small modular nuclear reactors (SMRs), as well as carbon capture and sequestration (CCS) from conventional coal-fired plants.
- Saskatchewan has substantial carbon sequestration capabilities within its prairie grasslands. The province punches above its weight in terms of sequestering CO₂. Canadian grain sequesters almost **80 megatonnes of carbon per year** but does not get credit for this under the IPCC GHG accounting protocols. Canadian cropland can sequester as much as **22 million tonnes** of atmospheric CO₂ per year through best management practices (BMP), such as zero-tillage.

Advocacy Efforts

- Shaping the Narrative - Contrary to popular belief, Carbon Dioxide is **not** a pollutant. All life on the planet depends on the presence of Carbon Dioxide. Carbon *Monoxide* is most definitely a pollutant and a deadly poison. However, the Earth can suffer from too much of a good thing. Atmospheric concentrations of CO₂ beyond 400ppm do pose very substantial risks.
- In future discussions with the Federal Government, the Chamber should emphasize the metric of carbon *intensity* (amount of carbon emitted per unit of energy consumed) over absolute carbon emissions. Canada is positioned quite well under the former.