



Federal Carbon Pricing Backstop

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WHAT IS THE FEDERAL CARBON PRICING BACKSTOP?

- Last week the federal government released long-awaited draft legislation on the federal carbon pricing regime. The policy's intent is to grant provinces and territories the flexibility to design their own systems, while providing some consistency in carbon pricing across the country.
- Provincial and territorial carbon pricing systems must meet certain criteria, called a "benchmark", which includes a) a price that begins at a minimum of \$10/tonne in 2018 and rises by \$10 a year to reach \$50/tonne in 2022, and b) it must cover a significant portion of the province's or territory's emissions.
- For those jurisdictions that do not meet these criteria, the federal government will impose the "backstop" carbon pricing system outlined in the draft legislation. Provinces and territories can also choose to apply the federal system rather than develop their own. The federal backstop legislation is expected to come into effect in 2019.

HOW WILL THE BACKSTOP WORK?

- The backstop will have two parts. First is a carbon levy that will be paid by either a distributor, importer or producer of fuels such as petroleum, coal and coke, natural gas, or combustible wastes. Fuel that is sold to farmers or facilities that emit above a certain amount of greenhouse gases (which will be subject to a different system) are exempt from the levy.
- Air, marine and rail carriers will be required to pay the levy only on fuel used within a jurisdiction subject the backstop. The levy will not apply to fuels that are simply being transported across a province or territory.
- For facilities that produce significant emissions, the costs of the levy would be very high and could push the business to relocate or deter investment, a phenomenon known as carbon leakage. The second part of the backstop is an output based pricing system intended to prevent carbon leakage while still creating an incentive for the facility to reduce emissions.
- An output based pricing system establishes a baseline for each industry. Facilities only have to pay for emissions that exceeds that exceed that baseline. Businesses pay for their excess emissions either in cash or through credits they earned through past emissions reductions, or that were purchased from other facilities. The system is an "output-based" model because the baseline will be set using emissions per unit of output as the standard.
- The government has proposed that the output based pricing system will initially apply to facilities that emit more than 50 kilotonnes of greenhouse gases a year starting with the following industrial sectors: oil and gas, pulp and paper, chemicals, nitrogen fertilizers, lime, cement, base metal smelting and refining, potash, iron ore pelletizing, mining, iron and steel, and food processing. The government is proposing that the baseline would be initially set at 70% of that industry's average emissions per unit produced.

HOW WILL THE BACKSTOP IMPACT MY BUSINESS?

- The federal backstop's impact on business will depend on where the business is located. The federal system will only apply in provinces and territories that do not meet the federal government's criteria. Since provinces and territories have until September 1, 2018 to outline their approach to carbon pricing, it is not yet certain where the federal systems will apply.
- Carbon pricing systems in BC, Alberta, Ontario and Quebec are expected to meet the federal government's criteria, meaning that businesses in those jurisdictions will not be impacted by the federal policy. Manitoba's proposed carbon levy will initially meet the government's criteria, but unless that price increases it may become subject to the federal backstop starting in 2020. Based on current provincial policies businesses in Saskatchewan, New Brunswick and Nova Scotia will likely be subject to the federal backstop when it goes into effect in 2019.
- In jurisdictions where the federal backstop does apply, its impact will depend on the share of fossil fuels in the provinces or territory's energy system. While official analysis of the cost of the backstop are lacking, economist Trevor Tombes estimated the average direct costs of a \$50 per tonne carbon levy on a household. His analysis found that costs range between less than \$500 per year for Manitoba, which has extensive hydroelectric resources, to \$800 a year in Saskatchewan, which is more reliant on natural gas and coal.
- How governments use revenues will play a role in determining the ultimate impact on business. The federal government will remit carbon pricing revenues to the jurisdiction where they originated, although they have not specified how the funds will be returned. Using carbon pricing revenues to reduce corporate or business taxes could mitigate some of the economic impacts of carbon pricing.

WHAT IS THE CANADIAN CHAMBER'S POSITION?

- The Chamber network has supported carbon pricing since 2011. The federal approach to carbon pricing allows provinces to make choices that reflect their unique economies and energy systems.
- However, the Canadian Chamber is concerned that both federal and provincial governments are choosing to layer regulation on top of carbon pricing policies, an approach that not only adds costs but negates one of the main benefits of carbon pricing: the flexibility it offers to business. In particular, we are concerned with the federal government's proposed Clean Fuel Standard, a substantial new climate policy that could have a significant impact on industry.
- As mentioned in the Chamber network July letter to the Prime Minister, carbon pricing is being introduced as the overall burden of government-imposed costs is hampering the competitiveness of Canadian business. As Canada moves forward with ambitious climate policies, we ask the government act to consider lowering costs elsewhere. A good place to start is comprehensive review of the Canadian tax system.

WHAT ARE THE GOVERNMENT'S NEXT STEPS?

- The federal government is soliciting comments on the draft legislation until February 12, 2018. The legislation is likely to be tabled in parliament sometime this spring.
- Consultations on the baselines for the output based pricing systems will be conducted by the federal government this winter and spring.