

Output-Based Pricing System (OBPS) Use of Proceeds Consultation

To:

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Introduction:

On behalf of Canadian Manufacturers & Exporters (CME) and our 2,500 direct members across the country, we are pleased to provide our comments on the Output-Based Pricing System (OBPS) use of proceeds consultation.

Manufacturing is the largest business sector in the country, directly accounting for 11 per cent of GDP, 66 per cent of exports, and 1.7 million employees in high wage, high skilled jobs in nearly every community across the country.

Manufacturing is also a critical driver of innovation, prosperity and jobs in Canada. Throughout its integrated operations and supply chains, the sector today directly and indirectly accounts for nearly 30 per cent of all economic activity and over 25 per cent of employment. Manufacturing also directly account for 35 per cent of all private-sector research and development, and 75 per cent of all exports.

Background:

While our members are concerned about the future impact that the Output-Based Pricing System (OBPS) will have on Canada's economy and the business operations of manufacturers, CME is pleased that Environment and Climate Change Canada (ECCC) has launched this consultation as we believe the revenues from the Output-Based Pricing System (OBPS) should be returned back to industry.

CME believes that all Canadians, including the manufacturing sector, have a responsibility to do what they can to address climate change. We fully agree with the government's view that a balance must be struck between the environment and the economy. We also agree that a global challenge requires global solutions. Canada is a small, open economy, that contributes a minimal amount of human-based GHG emissions. Canada accounts for about 1.6 per cent of global GHG emissions (745 Mt of CO₂ equivalent). If our emissions were to disappear tomorrow, those 745 Mt of GHGs would be replaced by new emissions growth from China alone in less than three years.

That said, the reality is that the high cost of doing business in Canada is eroding competitiveness and making it harder for companies to reduce emissions and their overall environmental footprint. According to the World Economic Forum, Canada has slipped in recent years in the rankings from ninth (in 2009-10) to 14th (in 2017-18) in terms of economic competitiveness. Since 2013, Canada has seen the slowest growth in business capital spending in the entire G-7, except for Italy. Investment growth is also two-and-a-half times slower than the Organization for Economic Cooperation and Development (OECD) on average and three times slower than in the United States. This has resulted in Canadian companies taking their capital out of Canada and investing in other jurisdictions, while foreign investment in Canada is drying up. In fact, since 2013, US investment in Canada has halved while Canadian investment in the US has tripled. And in the last four years, Canada has swung from a \$15 billion net inflow of investment from the US to a net outflow of nearly \$60 billion.

It is our view that Canada's current investment climate and the use of OBPS proceeds need to go together as they are being developed and finalized. The ultimate goal must be to create a business climate that will reverse the recent declines in investment, prevent capital and carbon leakage to neighboring competitive jurisdictions, and decrease emissions. The following are key principles that Environment and Climate Change Canada (ECCC) should follow when returning proceeds from the OBPS back to manufacturers:

1. **Business Certainty:** Funds paid into the system must remain available to the manufacturer that pays them. This is essential to ensure companies can better plan for future projects in line with their unique circumstances.
2. **Transparency:** Use of the proceeds by a manufacturer ("company") must result in real emissions reductions that can be independently verified. The system must also provide equal treatment for all OBPS participants.
3. **Flexibility:** Timelines for use of funds should recognize implementation factors for manufacturers including turnaround/outage schedules. Manufacturers must have the flexibility to use the funds in a way that reflects their ability to implement upgrades and/or adopt new technologies.

4. **Competitiveness:** Re-investing carbon compliance funds back to manufacturers enables Canada's manufacturing sector to remain competitive against companies in jurisdictions that do not incur equivalent carbon costs.

In line with these principles, CME believes that future action on reducing GHG emissions through the OBPS needs to reflect the following core statements:

- An uncompetitive business environment will drive investment out of Canada, hurting the economy, damaging our ability to generate innovative climate solutions, and resulting in higher global GHG emissions because of carbon leakage;
- Because of our relatively clean emissions profile, policies that result in more manufacturing activity in Canada and displace imports from high-polluting countries will contribute to a net reduction in global GHG emissions; and,
- All Output-Based Pricing System (OBPS) revenues collected from manufacturers need to be recycled back into the sector to help spark investments in reducing its environmental footprint and in generating technology solutions to the climate challenge.

The focus must be on ensuring consistent, outcome-based actions with respect to OBPS pricing regimes, not on wealth redistribution. If the desired outcome is to reduce emissions and grow the economy, we must ensure that we are measuring for these results and we must do it a way that is simple for business and consumers. We believe that the OBPS use of proceeds must be balanced and cannot compromise economic growth, industrial investment, or the global competitiveness of manufacturers. The be designed in such a way so that companies receive access to funds directly in proportion to how much they pay in carbon taxes or cap-and-trade expenses.

Canada cannot make a meaningful contribution to reducing emissions through the OBPS without the support of a thriving economy. The wealth generated from strong economic growth is an essential resource to spark the investment and innovation needed to grow manufacturing across Canada.

Reinvesting Output-Based Pricing System (OBPS) revenues back into manufacturing

We strongly believe that all funds raised under the OBPS should be used to address the challenges faced by OBPS covered manufacturing plants. Given this, we believe that the government should implement the following funds to allow for the recycling of revenues back to manufacturers to invest in their operations to lower GHG emissions and to ensure all companies whether they are mandatory participants of the OBPS or are voluntarily participants.

Company Specific Fund

The first fund for OBPS revenue recycling could be to allow for the revenue neutral distribution of revenues, where funds collected under the federal backstop and OBPS are returned to the "person" (the company) to invest in projects that support operating efficiency, innovation or competitiveness. We believe that simplicity,

predictability and transparency should be key in any of the criteria metrics and if a manufacturer meets those criteria, the funds should be available without delay.

This fund would help manufacturers of all sizes reduce GHG emissions and improve the overall competitiveness of Canadian manufacturing. This process must be administratively simple, timely, and transparent. Manufacturers should be able to “bank” the returned funds for a number of years and be able to “stack” these funds with other investment opportunities and/or incentives, so the companies can invest in impactful projects.

There should be no formal application processes required nor should there be a secondary adjudication process that could take months or get disrupted by economic or electoral cycles. It is our view that manufacturers should know at the start of the program what sorts of investments will qualify and they should be confident from the beginning that, if they meet the pre-determined criteria, the money is available. This fund satisfies the principles of increased competitiveness, encouragement of innovation, and of continuous improvement. The majority of a manufacturer’s compliance payment in any given year should be made available to that manufacturer for re-investment to improve their GHG emission profile and make that change.

The fund can be set up in several ways. The easiest and most effective option would be to establish a deferral account that would allow the booking (but not the actual transfer) of funds to a government entity. The actual cash would remain with the company and the payments would only be due to government when there are unused funds in the deferral account after the 3-6 or 4-8 year accrual period. A second option would be to set up the accounts as part of annual tax filing requirements. The Canadian Revenue Agency (CRA) could operate the deferral accounts according to taxation principals or administer the funds accrued as a tax credit. This would be a relatively low-cost option as both entities already administer carry back and carry forward taxation instruments on behalf of manufacturers for corporate taxation purposes. Neither of these options are ground-breaking and variations of them are already in use today in other commercial sectors.

Recommendation:

1. All a manufacturer’s compliance payment payable under the OBPS program in a given year be held in a company specific fund. This would:
 - Accrue funds for up to 3-4 years with a potential to extend to 6-8 years if:
 - o An emissions reduction capital project is imminent; and,
 - o Are less than 50% of the total project cost.

The longer time frame captures the traditional timing of an investment cycle and allows for flexibility for large investments (while the shorter timeframe recognizes political election cycles).

Large Emitters Fund

Canadian manufacturers may be low emitters compared to their foreign counterparts, but the fact remains that a small number of companies in specific industries account for the majority of Canada’s industrial

emissions. For this reason, targeted actions are needed that are aimed squarely at 5-10 of Canada's largest emitting sectors. A model should be considered for the largest emitters (and revenue contributors) whereas much money as possible is returned directly to the company for GHG reduction initiatives.

With the potential that some companies may be required to pay ten to hundreds of millions of dollars over the next four years, these largest emitters need the most assistance and can likely make the largest reduction impacts. This fund would require funding outside of OBPS proceeds since some projects may require more funding than a single province or company can accommodate, however, it would be set up to ensure funding for significant GHG reduction initiatives, research and development, and help keep industry competitive in Canada. It would also help mitigate competitiveness impacts from carbon pricing to allow for the 5-10 largest emitters choose the best emissions reduction projects to help reduce emissions. The timelines for this fund should be extremely flexible to recognize implementation factors for large emitters including turnaround/outage schedules. This is to ensure that large emitters have the flexibility to use the funds in a way that reflects their ability to implement upgrades and/or adopt new technologies.

Recommendation:

1. The federal government should create a \$1-billion fund that specifically targets investment projects to reduce GHG emissions in Canada's 5-10 highest-emitting industries.

General Proceeds Fund

A general proceeds fund for each covered OBPS manufacturer would recognize how each sector has different emissions profiles, technological processes and most importantly different operational benchmarks for the products they produce. These "best in class plants" will not necessarily pay funds into the OBPS and as a result will not be able to make use of the deferred funds for future investment. However, as investments are made in high emissions facilities, the overall benchmark will decline, as a "best in class plant" at the beginning of the program may not mean best in class a few years later.

This proposal for a general proceeds fund would distribute the funds based on a competitive application process that encourages innovation and helps drive continuous improvement in emissions intensity for manufacturers. CME believes the General Proceeds fund should focus its program strictly on capital investments in existing plants instead of a broad focus on research and demonstration applications. By concentrating its efforts on existing plants, the General Proceeds funds will help lower the overall emissions intensity for Canada's manufacturing base and helping to ensure that Canada remains competitive during the transition to a low carbon future. The framework for drawing on the General Proceeds Fund should be designed to ensure opportunities for all OBPS covered plants to acquire the lowest cost GHG reduction technologies. The system should be transparent, predictable and open to all within the sector.

Recommendation:

1. To incent GHG reduction investments by all manufacturers, we recommend that the government establish a general proceeds fund for each OBPS covered sector that can be drawn on to fund the lowest cost investments. The funds would be:

- Initially seeded by a portion of a manufacturers compliance payments and then recharged by the transfer of unused funds from the individual manufacturer.
- Available for ANY regulated party within that sector for investments in GHG reduction technologies.

Nation-Wide SMART Program

CME sees a focus on avoiding duplication, supporting the lowest cost reductions, addressing competitiveness, encouraging technological innovation and supporting low-carbon investments for the future low-carbon economy. There is also a need to improve the supports available for smaller-scale adoption of environmental technologies. As mentioned above, these supports should focus on low-hanging fruit – companies that are medium to high emitters in proportion to their industry counterparts. A national program modelled after the former SMART program delivered through FedDev Ontario could help medium to high-emitting businesses identify, adopt and implement new technologies that reduce their environmental footprint. Manufacturers should be eligible for funding in direct proportion to how much they pay into the OBPS pricing scheme.

Recommendation:

1. The federal government should support the creation and delivery of a nation-wide environmental SMART program that would:
 - Be geared to medium to high-emitting companies, regardless of size and to companies that voluntarily opted-into the OBPS;
 - Funding for breakthrough advanced manufacturing technology developments;
 - Offset the cost of technology assessment and diagnostic services; and,
 - Provide support for investment in reducing GHG emissions and improving energy efficiency.

Along with implementing the recommendations around OBPS use of proceeds, we believe the following recommendations around preventing carbon leakage from Canada and providing support for developing environmental solutions should complement how the use of OBPS proceeds go back into industry to ensure we are addressing climate change effectively and balancing the environment and the economy. Our recommendations can be found below.

Preventing carbon leakage from Canada

Uncompetitive economic policies create the risk that Canada will lower its domestic GHG emissions by exporting economic activity to countries where environmental standards are laxer. Poorly designed carbon pricing systems and other uncompetitive policies will drive manufacturing production out of the country. We will lose well-paying jobs and, through carbon leakage, global GHG emissions will increase. Accurate global benchmarks are needed to demonstrate the global benefit of manufacturing more in Canada.

Canadian businesses in emissions-intensive industries have a generally lower emissions profile than many of their international competitors. For this reason, government policies that encourage the use of domestic inputs could have a net positive effect on reducing emissions at the global level.

Moreover, one of the results of these initiatives is that they raise the cost of doing business in Canada and erode our global competitiveness. Imports from high-polluting countries without comparable carbon pricing systems risk displacing our cleaner goods, while our manufactured goods exports will be at a disadvantage in those markets. This result is counterproductive to the overarching goal of global GHG emissions reductions.

Recommendations:

1. The federal government should introduce an export tax credit for businesses that export to countries without carbon pricing systems comparable to our own.
2. The Government of Canada should establish procurement policies and enabling tools that recognize and take in consideration the inherent carbon benefits of Canadian manufactured goods in domestic infrastructure projects.
3. In partnership with the business community, the Government of Canada should develop, generate, and disseminate environmental performance benchmarks that accurately compare emissions from Canadian manufacturers with those from other countries

Supports for developing environmental solutions

Canada's most valuable contribution to the climate challenge is to be a leader in developing innovative solutions. That means increasing government supports for the development of emissions-reducing technologies, products and processes; as well as making it easier for businesses to identify and adopt those technologies. At present, Canada's R&D supports emphasize basic and applied research, as well as experimental development. They have also grown increasingly difficult to access. By contrast, US tax credits are more easily available and specifically include support for the development of new or improved products and processes – the kind that lead to significant GHG emissions reductions.

Recommendation:

1. To expand Canada's ability to develop emissions-reducing technologies, the federal government should:
 - Create an electronic business-to-business match-making service to connect Canadian innovators to purchasers.