CARBON LEAKAGE, TRADE EXPOSURE AND THE FEDERAL BACKSTOP
CRITICAL INSIGHT FORM ENERGY-INTENSIVE, TRADE EXPOSED INDUSTRIES INCLUDING CEMENT, FUELS, STEEL AND CHEMICALS

By Melodie Michel for Canadian Clean Energy Conferences

Learn more on this topic from industry associations at Carbon Pricing for Canadian Industry, April 25-26, Hilton Toronto
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The corporate carbon pricing landscape across Canada is anything but a level playing field. For one, some provinces have implemented their own system, while others are complying with the federal plan. And even within this plan - the Federal Backstop - different sectors are expected to implement different benchmarks. Here is how Canadian industry is navigating its tricky carbon policy framework.

Trade exposure and leakage risk

One of the main concerns expressed by industry associations about the Federal Backstop is that trade exposure may not have been taken into account to the extent it should be. Most sectors currently have an emissions target of reducing their current average by 20%. Under the Federal Backstop’s output-based pricing system (OBPS), companies that succeed in emitting 80% or less of their sector average will be rewarded, but those that fail will have to pay up.

Since the initial consultations with the federal government, a number of energy-intensive, trade-exposed (EITE) sectors, including steel, cement and oil and gas, have argued that these targets would put them at a competitive disadvantage compared to other parts of the world - or even other parts of the country. On top of putting industry at risk, it would also pose the issue of carbon leakage where greenhouse gas emissions would simply move from one place to the other.

This is what happened in the cement sector when British Colombia implemented its carbon tax in 2008. “The carbon tax does not account for EITE issues,” explains Adam Auer, Vice President of Environment and Sustainability at the Cement Association of Canada.

“We didn’t see a reduction of global emissions, but a displacement of emissions from BC to competing jurisdictions, and of course a reduction of investment and jobs in that province.”

Adam Auer, Vice President of Environment and Sustainability, Cement Association of Canada

Peter Boag, President and CEO of the Canadian Fuels Association (CFA), says the sector supports the OBPS system which, “if well designed”, can protect Canadian industries against potentially negative competitiveness impacts and carbon leakages. “Where we take issue is that the 80% target still applied to the sector is unachievable. No refinery in
Canada meets that standard today, and very few refineries in the world could," he says. Last summer, CFA did an extensive economic analysis around the economic and trade exposure risks in the industry and proposed that the standard should be raised to 90% of sector average. “We were quite hopeful and optimistic, given the level of detail and the results of that analysis. But when the draft regulation was published, that was not the case,” recalls Boag. Among those who did get the 90% target, some are more satisfied than others. “We think it should be much higher,” says Catherine Cobden, President of the Canadian Steel Producers Association (CSPA), citing damaging trade action from the US and global trade disruptions as some of the main challenges for the sector.

Both the steel and oil and gas sectors plan to continue making their arguments to the federal government, and this continued consultation may bear its fruits, judging by what happened in the cement sector.

After a further risk assessment, it was determined that cement’s target should move up to 95% of the national sector average. “We see this as a strong indication that the federal government was taking this issue seriously, and though the system will still have significant costs for the cement sector, this target brought our sector more or less in line with the type of compliance costs we would have faced under the former Ontario Cap and Trade program,” Auer comments.

**Duplication and inconsistencies**

The final cost of compliance to the Federal Backstop is yet to be determined, especially since OBPS benchmarks are not yet finalized. But one thing could make the bill very expensive, and that is the duplication of policies. “There’s a full suite of regulations, and it’s not clear that they don’t overlap and duplicate each other, specifically the Clean Fuel Standard and the Federal Backstop. The last thing we want to do is pay twice for our carbon fuel,” says Shannon Watt, Director, Environment and Health Policy at the Chemistry Industry Association of Canada.

The Clean Fuel Standard aims to reduce carbon emissions from all fuels by 30 million tonnes in 2030 by setting lifecycle intensity requirements for fuels used in transportation, industry and other sectors. Proposed regulations for liquid fuels should be published this spring, with the final requirements coming into force by 2022. For gaseous and solid fuels, the deadline is set a year later. At this point, nothing is set in stone for this standard, but industry should bring the duplication risk to the attention of the federal government.

Considering the speed of implementation of the Federal Backstop in certain provinces, ensuring every little detail is taken into account isn’t always easy. “It’s been a really rushed process for us, as most of our facilities are in Ontario. It took three years to develop the framework under the Cap and Trade regulations, and we’re doing this in less than six months. We’re worried that they’re not going to get it right,” adds Watt.

Policy inconsistencies are another issue: the cancellation of the Cap and Trade program was a blow for Ontarian companies, but the Federal Backstop may not be their final regulation, since the province has launched a legal challenge against its implementation, and is drafting a new program of its own. A similar situation is going on in Saskatchewan, and the upcoming election in Alberta could see the cancellation of the carbon levy, so industry is facing more questions and uncertainty.
“Look at the patchwork of emissions requirements that have emerged: in the Eastern supply orbit, which includes the refinery-rich provinces of Ontario, Quebec and New Brunswick, but also large parts of the Eastern US and other markets throughout the Atlantic Basin, we’re now in a situation where the compliance costs for refineries in New Brunswick and Ontario, governed by the Federal Backstop, will be four times the cost of refineries in Quebec under the Cap and Trade system. We’ve set up a system of huge market distortions within a single supply market, due to differing carbon costs,” explains Boag at CFA.

Research and investment

Research into low-carbon technology is a rather rich field in Canada, and industry is well aware of promising innovations. The cement sector, for example, has been slowly transitioning away from traditional fossil fuels to biomass and other waste products. According to Auer, there are many active fuel-switching projects happening around the country, whereby companies are investing in the infrastructure needed to handle and store these biofuels.

“We expect the percentage of substitutions to climb over the near term,” he adds. “A big part of our ongoing work with government is to make it easier for us to access those alternative fuels and to get the permits to use them.”

In recent years, the industry has also invested in and promoted the introduction of Portland-limestone cement, a type of cement with 10% lower greenhouse gas intensity than the regular type. But ensuring that government procurement agencies are specifying this type of cement in their project seems to be an uphill battle.

For steel, the challenge is to remove or replace carbon in production processes - particularly with the inclusion of process emissions into the Federal Backstop. “Carbon is a core part of our manufacturing process. You need it to create the chemical reaction necessary to make steel. We have a portion of our emissions that comes from our manufacturing operations, and that’s what we’ve been driving downwards, but then we have a portion that comes directly from our input streams, and that is very difficult to deal with,” notes Cobden.

Research is ongoing, namely around the replacement of carbon with biocarbon in processes, but the technology isn’t yet ready to be commercialised - leaving steel manufacturers to pay a potentially hefty tax on process emissions.

The same is true of the chemistry sector. “We’re the first jurisdiction in the world that’s looking to reduce process emissions, and it’s concerning for us. Depending on the chemistry and its stability, it could have big implications,” says Watt.

Among carbon reduction strategies, the sector is looking at fuel switching, process and product changes, feedstock substitutions, and other technologies. In fact, chemistry companies are very well-placed to benefit from the industrial need to reduce carbon exposure by coming up with new low-emissions products that could be used in manufacturing and other sectors. But the question is: will they get the investment needed to develop innovations?

“I’m not that hopeful about investment,” says Watt. “We saw what the last provincial election did to our Ontarian members, and we’re facing two more elections, one in Alberta and one at the federal level. We need...
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Catherine Cobden, President, Canadian Steel Producers Association (CSPA)

large-scale investments to get low-carbon solutions and technologies, but it’s not even clear that the environment policy is going to stay the same between now and 2020, so it’s really hard to make the case for it.” Most of Canada’s industrial sectors have been committed to reducing their emissions since before any kind of carbon regulation was put in place. But while the necessity for environmental policies is undeniable, the uncertainty they are creating is complicating carbon reduction roadmaps for key industries currently.

Join industry leaders to get the very latest updates on carbon compliance and strategies including:

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