THE POLITICS OF EMISSIONS REDUCTION IN ONTARIO PART 2: PATHS FORWARD

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This is the second part of a two-part paper. Yesterday's paper, on the history of emission reduction in Ontario is here. This second part focuses on suggested paths forward.

Introduction

As outlined in part one of this two-part policy briefing, political consensus was reached at the beginning of the 21st century to exit coal-fired electricity generation. Can Ontario re-create consensus in the more partisan climate of the 2020s?

Then-federal Minister of Natural Resources, Seamus O'Regan, noted in a July 2021 interview: "If you are intent on significant change, but do not manage that with the prosperity of people and with a certain amount of economic prosperity, you will be voted out."[1]

The next Ontario government, regardless of political stripe, faces a significant crossroad regarding the economic growth and prosperity of the province. Consumer choice is quickly driving firm behaviour toward lower carbon/net zero products often in hard-to-abate sectors such as steel, cement, airlines. Financial regulators globally have shifted rapidly (relative to the normal pace of change in that sector) to recognize the physical and transition climate risk faced by the real economy and by financial institutions. The cost of renewables continues to decline relative to existing fuel sources. And evidence continues to mount not only on the climate risks facing Ontario and Canada, but on the economic costs of inaction.

Energy transition is not only a "climate" challenge. It is a challenge for the ongoing success and prosperity of the Ontario economy. If Ontario cannot or will not meet the market demands of industry and service industry customers, and if it cannot meet the financial regulatory thresholds expected by international investors, other jurisdictions will. And these other jurisdictions will in turn attract new capital, innovation, and new jobs. Quebec set out an ambitious energy transition strategy in 2020, allocating $6.7 billion to support the electrification of transportation, industry, buildings, and government services.[2]

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[1] The Hon. Seamus O'Regan. David Herle, *The Herle Burly* podcast, July 20, 2021. https://www.theherleburly.com/episodes/seamus-oregan-polipanel

[2] Government of Québec, "A Win-Win for Québec and the Planet: 2030 Plan for a Green Economy." https://www.quebec.ca/en/government/policies-orientations/plan-green-economy#:~:text=The%20Plan%20will%20help%20achieve,the%20consequences%20of%20climate%20change

For Ontario to remain competitive, business as usual will not be sufficient. Governments and the private sector will need to collaborate more than during the past twenty years. Transition will require significant capital to reset the way business operates. Governments will need to play a significant financial role in that transition.

To support the continued growth of the Ontario economy, the next provincial government should set an energy transition pathway that delivers growth to fuel job creation and development of new products and new markets, and continues the province's enviable record on emissions reduction. A combination of economic growth and emissions reduction could even create broader political consensus.

Four components will interact to attain these objectives.

1. Climate Policy Certainty

The first is a fundamental principle of climate policy certainty necessary for effective progress on climate goals, whether for mitigation or adaptation.

When the cap-and-trade system was scrapped in 2018 without a replacement being introduced, Ontario business lost all certainty regarding longer-term emissions policy. Re-establishing trust in policy certainty is fundamental to ensuring the sustained development of the province's economy and an effective and efficient reductions in emissions.

This challenge holds true for climate policies at both the federal and provincial level. The ongoing debate within the federal Conservative Party makes for great headlines in some circles. It makes for less-than-optimal outcomes as business wrestles with the political and financial risk associated with future investments in capital and innovation.

2. A "Made-for-Ontario" Energy Transition Strategy

The current government has recognized the dual challenge of economic development and market demand for lower carbon products. Its investments have been a series of "one-off" opportunities.

A *"Made for Ontario" Energy Transition Strategy* would benefit the Ontario economy, its energy sector partners, consumers, and the business community. This strategy sets the context for priorities, provides capital markets with greater certainty on investment opportunities and timelines, and offers consumers and businesses perspectives on future opportunities and costs.

Quebec, in its "Plan for a Green Economy," sets out an aspirational target to "replace imported fossil fuel with green energy produced here in Quebec."[3] The province estimates that imported oil generates over 50% of its GHG emissions and costs government, business, and consumers some $8.5 billion annually. Its formal target is to reduce petroleum demand by 40% by 2030.[4] Leveraging its 99% clean energy hydro grid, the Quebec plan sets out a detailed pathway to electrify industry, buildings, and transportation. It has allocated some $770 million to support industry's transition to lower carbon fuel use.

Ontario can authentically claim an exceptionally clean grid, but the pathway to reduced emissions across the provincial economy will be more complicated. Unlike Quebec, electrification is a fundamental but not the only policy option that Ontario should pursue.

In the same interview cited earlier, O'Regan was asked about possible pathways to a net zero future. His response: "I don't look to anything as a panacea. I don't believe in panaceas. It will be a mix of everything."[5] The same applies to the Province of Ontario.

A **"Made-for-Ontario" Energy Transition Strategy** would address climate risks and economic opportunities in the province. These should:

1. Incent use of lower carbon, renewable, and alternative fuels for the transportation and building sectors:

    a. Canada is today one of the top ten global hydrogen producers.[6] Build on the proposals in the Ontario government's own "2020 Hydrogen Discussion Paper" and Ottawa's "2020 Hydrogen Strategy for Canada" to increase production and market expansion of hydrogen for commercial transportation and in the heating of residential and commercial properties;

    b. Support market development and opportunities for renewable natural gas by establishing targets and permitting blending in the natural gas distribution system. Permit municipal utilities to procure hydrogen in lieu of natural gas;

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[3] Government of Québec, "Good for Québec. Good for the Earth." https://www.environnement.gouv.qc.ca/plan-economie-verte/en/bref.htm

[4] Government of Québec, "A Win-Win for Québec and the Planet: 2030 Plan for a Green Economy," p. 15. https://www.quebec.ca/en/government/policies-orientations/plan-green-economy#:☐:text=The%20Plan%20will%20help%20achieve,the%20consequences%20of%20climate%20change

[5] The Hon. Seamus O'Regan. David Herle. *The Herle Burly* podcast, July 20, 2021. https://www.theherleburly.com/episodes/seamus-oregan-polipanel

[6] International Energy Agency. Canada 2020 Energy Policy Review, p. 71. https://www.iea.org/countries/canada

c. Consider the cost and operational implications of a portfolio standard for renewables (solar and wind) and lower carbon standards for new fossil fuel consumption at OPG; and

d. Continue to encourage utilities and the private sector to pilot lower carbon residential heating opportunities such as "hybrid" residential initiatives that combine natural gas and electrification.

2. Reinforce the role of low carbon fuels for electricity generation:

   a. Continue to invest in nuclear as a significant contributor to OPG's fuel mix;

   b. Amend Ontario and OPG's Green Bond frameworks to include the financing of nuclear energy as well as fossil fuel investments that reduce GHG emissions (of particular relevance given the recent EU decision to include nuclear as a "low-carbon" energy source in its Taxonomy on Green Finance [7]); and

   c. Support ongoing investment in and decarbonization of Ontario's natural gas generating facilities by permitting the blending of renewable natural gas (RNG) and hydrogen as permitted fuel sources.

3. Provide financing or co-financing in support of energy transition for heavy industry and Ontario's hard-to-abate sectors, as well as other, lower carbon emitting sectors:

   a. Establish investment priorities that identify significant emitters and partners with Ottawa (through financial programs like the Strategic Innovation Fund) to co-fund projects that support investments that enhance economic development, energy transition, and GHG reduction;

   b. Enable lower-emitting sectors (agriculture, forestry) to access funding in support of emissions reduction investments.

4. Partner with Ottawa's 2021 Greener Homes Grant to financially enhance support for residential energy conservation and efficiency programs, including support for Indigenous communities.

[7] EU Questions and Answers. February 2, 2021. https://ec.europa.eu/commission/presscorner/detail/en/qanda_22_712

How financial incentives are paid to firms is an additional policy challenge. Options include direct subsidies, low interest loans, or loans contingent on future market prices for carbon emissions. One innovative approach has suggested that the balance sheet of the Canada Infrastructure Bank could be leveraged to risk-share uncertainty over the future price of carbon.[8]

3. Pricing Emissions

The third opportunity is to re-establish an explicit price on carbon emissions.

Whether by means of an explicit price (via carbon levy or cap and trade) or an implicit price through regulatory options, the most efficient way to reduce carbon emissions remains one that works through the price mechanism.

Incumbency can provide electoral advantage and so, simply on that basis, one might infer that the current government is likely to be returned to office in June 2022. Since the current provincial government cancelled Ontario's cap-and-trade program, it would be unlikely to reverse course and re-establish that mechanism. Since Ontario lost its Supreme Court challenge on Ottawa's authority to implement a price on carbon, a "made-for-Ontario" carbon levy might appear unlikely.

Other parties in the election would embrace a return to emissions pricing.

With the cancellation of cap and trade, Ontario became subject to Ottawa's retail carbon levy. Ottawa sets the standards, collects the revenue, and decides how and where the proceeds are distributed.

A "Made-for-Ontario" Energy Transition Strategy will need significant financial investment to deliver the economic development benefits associated with transition. In a post-COVID financial world where Ontario's debt remains significantly higher than that of other sub-national jurisdictions, the province has limited ability to fund new initiatives if public debt is to be brought under control.

It is time for a ***"Made-for-Ontario" Emissions Price***.

Were Queen's Park to implement its own provincial emissions levy, the Ontario government would collect the revenue. It would also determine how best to use those revenues to ensure public support while also advancing economic development of the province.

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[8] D. Beugin and B. Shaffer, "The Climate Policy Certainty Gap and How to Fill It," CD Howe Intelligence Memo, June 4, 2021. https://www.cdhowe.org/intelligence-memos/buegin-shaffer---climate-policy-certainty-gap-and-how-fill-it

Rather than simply replacing the current federal tax with an Ontario replica, particularly as the carbon price rises annually and revenues grow, an Ontario emissions levy could fund or mitigate:

1. Tax neutrality for lower income Ontario residents through a quarterly rebate;
2. The one-time capital costs of Ontario's heavy industry, fuel, transportation, and building sectors to adapt and invest in the transition to a lower carbon fuel mix; and
3. The financial inequities that the current federal carbon levy system imposes on Ontario's agricultural sector and remote/northern communities.

4. Investing in Innovation

The fourth opportunity is to advance the ability to scale technologies that support emissions reductions across industrial sectors.

The pathway to achieving Canada's 2030 carbon emission objectives is relatively well understood and will draw on known technologies. It will be based on a combination of emission caps, incentives to promote fuel substitution, and incenting initial fleet transition to EVs, among others.

It is also likely fair to suggest that the pathway to "net zero by 2050" is unknown, or uncertain at best. This is not a function of a lack of political will or commitment. It is a function of uncertainty as to which pathway will achieve the goal of net zero at the lowest cost to the economy. For that reason, Canada and Ontario cannot ignore any potential opportunity to invest in emerging technologies that could contribute to emissions reductions over the coming three decades.

It is in Ontario's interest to think like a merchant bank about a 2050 pathway. Ontario should be placing financial bets on a broad range of technologies and potential fuel sources, knowing that some of them will succeed while others fail. In addition, new technological discoveries will be made that are yet unknown. The challenge for Ontario today is that one simply does not know what options will deliver better outcomes at the lowest economic cost.

Where could Ontario place its bets today? Two immediate opportunities stand out:

1. Continue to pursue the financing and R&D objectives of the 2021 Small Modular Reactor (SMR) Interprovincial MOU (Ontario, New Brunswick, Alberta, and Saskatchewan) to advance SMR technology as one source for increased demand for electricity at zero emissions and for application in "off grid" use in the resource sector. This option also supports the development of a potentially valuable export commodity.

2. Provide incentives to grow and scale Carbon Capture Utilization and Storage (CCUS). The International Energy Agency, in its Canada 2022 Energy Policy Review, and the Canadian Institute for Climate Choice both recognize CCUS as "one of the critical transformative technologies for enabling deep reductions across a range of sectors in Canada to 2050."[9]

    a. An explicit price on carbon is a fundamental requirement for the successful commercial development of successful and scalable CCUS;

    b. Ontario can amend its "Oil, Gas and Salt Resources Act, 1990" to permit exploration and development of CO_2 underground storage sinks;

    c. Partner with Ottawa and its Strategic Innovation Fund (SIF) – Net Zero Accelerator to identify opportunities in hard-to-abate sectors (cement, steel) for scalable CCUS investments.

Conclusion

The 2022 Ontario election is an opportunity to focus on the economic development benefits of an inclusive energy transition strategy, including further reductions in GHG emissions. The province, perhaps unwittingly, set an enviable track record on GHG emissions reduction over the past two decades by reaching political consensus on coal phase-out. There are significant and economically beneficial ways to continue that journey.

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[9] International Energy Agency (IEA), Canada 2022 Energy Policy Review, p. 69. https://www.iea.org/countries/canada