NACC
National Airlines Council of Canada

CNLA
Conseil national des lignes aériennes du Canada

SUBMISSION TO THE STANDING COMMITTEE ON ENERGY, THE ENVIRONMENT AND NATURAL RESOURCES

Pre-study on Part 5 of Bill C-74

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WHO WE ARE

The National Airlines Council of Canada (NACC) is the trade association representing Canada's largest passenger air carriers: Air Canada, Air Transat, Jazz Aviation LP, and WestJet. We advocate for safe, environmentally responsible, and competitive air travel by promoting the development, by governments, of policies, regulations and legislation to foster a world-class transportation system.

Collectively, NACC member airlines carry over 71 million passengers annually and directly employ more than 50,000 people across Canada. NACC member airlines are responsible for almost 90 per cent of domestic passenger air traffic and 65 per cent of international air traffic in Canada. Our members fly to 243 destinations around the world in 64 countries, including 66 destinations in Canada.

For more information on the National Airlines Council of Canada, please visit our website at: www.airlinecouncil.ca

INTRODUCTION

On April 24, the Senate of Canada agreed to conduct a pre-study of Bill C-74, the Government of Canada's Budget implementation Bill.

The Senate Committee on Energy, the Environment and Natural Resources was authorized to examine Part 5 of the Bill (the *Greenhouse Gas Pollution Pricing Act*) which forms the legislative foundation for the Government of Canada's *Pan-Canadian Framework on Clean Growth and Climate Change,* and to submit its report by the end of May.

The National Airlines Council of Canada welcomes this review as it provides an important opportunity to address the fundamental policy issues raised by the Government of Canada's current approach to the pricing of aviation carbon emissions.

Our organization -- and indeed Canada's commercial aviation sector as a whole -- has repeatedly highlighted that as a market-based measure, the carbon tax is not well suited to commercial aviation in general, and particularly ill-suited to the Canadian context. An output-based carbon pricing system, such as that provided for in federal policy and in this Bill for large emitters, and similar to the international Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) Agreement, is much better suited to the global and domestic realities faced by Canada's commercial airlines.

This submission provides background on the current global and domestic initiatives to reduce the airline sector's carbon footprint; an assessment of the Government of Canada's policy in this area as evidenced by the Bill before this Committee; and finally, makes some recommendations with respect to the Bill, and more importantly, with respect to policy.

BACKGROUND

Aviation: A Sector Committed to Reducing its Carbon Footprint

According to recent figures from the United Nation's Intergovernmental Panel on Climate Change (IPCC), aviation (domestic and international) accounts for approximately two percent of global man-made CO2 emissions, with international air transport accounting for 1.3 percent. According to the International Air Transport Association ("IATA"), air transport's relative carbon contribution has not increased in the past 20 years and is not expected to increase beyond 3 percent (of man-made emissions) by 2050.

Canada and its passenger airlines have been leaders in efforts to reduce growth in air transport emissions. The aviation industry recognizes the need to address climate change challenges and has demonstrated its commitment for positive change through a number of domestic and international initiatives.

Chronology of recent initiatives

In 2008, leaders from the aviation industry (airlines, airports, air navigation service providers and manufacturers) presented the world's first global air transport sector climate action framework (the "Global Framework"). The framework is based on a set of three global goals, underpinned by four pillars of climate action.

- The 2008 goals were a set of ambitious targets to mitigate growth in air transport CO2 emissions, set in short, medium and long-term horizons. IATA and its airline members also agreed to those targets, which are as follows:
    - Improve average fuel efficiency by 1.5% per year from 2009 to 2020;
    - Cap net aviation CO2 emissions from 2020 (carbon-neutral growth); and
    - Reduce net aviation carbon emissions by 50% by 2050, relative to 2005 levels.
- The 2008 four pillar strategies aim to support climate action through the following:
    1. Improved technology, including more efficient aircraft and engines, and the deployment of sustainable alternative fuels;
    2. More efficient aircraft operations through improved flight planning and air traffic control procedures at airports, enabling less fuel to be boarded and less emissions released;
    3. Infrastructure improvements, including modernized air traffic management systems; and
    4. A single Global Market-Based Measure ("GMBM") to fill the remaining emissions gap, accounting for emissions only once to ensure passengers will not face multiple tax layers.
- In 2010, the 37th Session of the ICAO Assembly adopted three goals for aviation:
    1. A global annual average fuel efficiency improvement rate of 2 per cent until 2020;
    2. An aspirational global fuel efficiency improvement rate of 2 per cent per annum from 2021 to 2050; and
    3. A collective medium-term global aspirational goal of maintaining global net CO2
- Canada's Action Plan to Reduce Greenhouse Gas Emissions from Aviation ("Action Plan") – In June 2012, the joint industry-government Working Group on Aviation Emissions created the

Action Plan. It aligned its target with the Global Framework's commitment which called for an improvement in fuel efficiency of 1.5 percent per year until 2020. The Action Plan also calls on Canada to pursue an aspirational goal of improving the fuel efficiency of Canada's air carriers by 2 percent per year until 2020 (the same aspirational rate set by ICAO in 2010).

- On October 6, 2016, nearly all 191 states represented at ICAO, including Canada, adopted the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA). Under this plan, aircraft operators will need to purchase offsets, or "emission units", for the growth in CO2 emissions from international aviation above 2020 levels. CORSIA is set to commence with a voluntary period (2021-2026) after which it will become mandatory. Nearly 70 states, including Canada, have already agreed to implement the plan from its outset, covering approximately 80 percent of CO2 growth in 2021-2035.
- Importantly:
    - CORSIA reaffirms earlier ICAO policy resolutions that find that MBMs must be considered as <u>one</u> element in the context of a <u>comprehensive basket of state measures to reduce aviation related emissions</u>, including investments in biofuels, air navigation improvements, engine technology improvements, etc.
    - As a GMBM, CORSIA will complement the goals and pillars of the 2008 global air transport framework, and in particular, to work towards achieving the global aspirational goal of carbon-neutral growth from 2020 onwards.
    - CORSIA calls on signatory states to avoid duplicative MBM to avoid double-taxation of international aviation CO2 emissions.

PAN-CANADIAN FRAMEWORK ON CLEAN GROWTH AND CLIMATE CHANGE

In October 2016, the Government of Canada unveiled its pan-Canadian approach to pricing carbon pollution (also known as the benchmark) which spelled out the policy foundations of the government strategy to meet its obligations under the Paris Accord.

This benchmark provides provinces and territories with flexibility to implement their own carbon pollution pricing systems. In the benchmark, the federal government also committed to implementing a federal carbon pricing backstop system that will apply in any province or territory that does not have a carbon pricing system in place by 2018 that aligns with the benchmark.

Last May, the Government released the backstop which serves as the basis for Part 5 of Bill C-74.

What is perplexing is that while the backstop recognizes the potential impact on trans-border competitiveness and and/or emissions leakage that would arise from a carbon tax and provides for an output-based system including the use of "foreign compliance units" to mitigate such impacts, it does not extend this option to the aviation sector, opting instead for a carbon tax.

NACC notes the following three core policy concerns with the backstop approach:

1. While recognizing risk of economic and emission leakage inherent in the imposition of a carbon tax, the Backstop fails to take into account the unique competitive environment of Canada's

aviation system; including close proximity to the lower cost U.S. marketplace and high-level of price sensitivity of demand for air passenger transportation.

2. The backstop – as was the Benchmark – is silent on optimal use of tax carbon tax revenue and does not provide direction or incentives for any government to use such revenues to invest in ancillary measure designed to enhance emission reductions. With respect to aviation, this is particularly concerning since, in the medium term, carbon pricing alone will not result in emission reductions.
3. The backstop approach, as reflected in this Bill, is insufficient to fully comply with Canada's obligations as a signatory to CORSIA which include the requirement to pursue a basket of measures to support additional emission reduction strategies

ALTERNATE APPROACH AND IMPROVED BENEFITS FOR CANADA

NACC recognizes that the Government of Canada's overall policy framework is focused on reducing GHG emissions as part of meeting commitments under the PCF and COP21 and, as a sector that is very sensitive to weather events and with members with deep roots in communities from coast to coast to coast, we support this.

However, the carbon pricing scheme for aviation provided for under the Government's policy and reflected in this Bill, is not adapted to commercial aviation. For Canada's domestic aviation sector, we strongly advocate the use of an output based or CORSIA-like framework to manage pan-Canadian emissions.

Compared to the carbon tax levy proposed for aviation, an output based offset scheme will promote the following benefits: (1) Encourage real and measurable carbon reductions; (2) effect lower costs for air carriers and passengers; (3) be less onerous to administer; and (4) result in greater environmental and economic benefits for Canada.

Trade-exposed aviation sector and sensitivity of leisure travellers to added cost

When assessing the appropriateness of various policy options in this area, it is critical to note that Canada's commercial airline industry is a trade-exposed sector, characterized by demand that is highly sensitive to price. This makes Canadian aviation highly susceptible to competitive and emissions leakage – the two policy foundations for an output-based carbon pricing regime in the backstop, and importantly, in the CORSIA framework.

The close proximity of U.S. border airports to the majority of Canada's population means that U.S. and international carriers operating from these airports can take advantage of Canada's higher burden of taxes, fees and other charges on commercial aviation. Indeed, as recent studies have shown, approximately 2.5 million Canadians (roughly representing 5 million flights) fly in and out of U.S. border airports. Any additional cost burden has a risk of increasing that number.

The number of passengers for whom Canadian airports could be at risk to U.S. cross border airports would be driven by the following three factors:

1. Domestic carbon pricing on the domestic leg of a transborder or international journey;
2. Price elasticity that increases exposure for the bulk of passenger volume – the price sensitive leisure segment; and
3. The outright level of carbon pricing.

As the Canadian Transportation Act Review noted, it is critical that carbon pricing be kept competitive versus rates for international aviation, and that the rates are kept to the lowest level possible given the already high burden in Canada of taxes, fees and other charges on commercial aviation.

Regarding the second point, price elasticity for the leisure travel segment can equally affect domestic travel and the domestic legs of international trips. The majority of domestic air travel in Canada is undertaken by the non-business segment, comprised of leisure, vacation, visiting friends and relatives, shopping and other sub-sets (in aggregate entitled "leisure travel segment"). In 2016, nearly 93 percent of total domestic travel (by all transportation modes) was undertaken by the non-business segment and accounted for just over 88 percent of total domestic travel expenditures. Only 8.3 percent of domestic travel was undertaken by commercial air transport – the remainder by car, bus and rail.

The leisure air travel segment demonstrates a higher degree of price sensitivity (or "elasticity of demand") than the business segment. According to IATA, "…business travellers are less sensitive to price changes (less elastic) than leisure travellers…" [because] "…business travellers generally have less flexibility to postpone or cancel their travel than leisure travellers." Similarly, Canada's Department of Finance noted that "…leisure travellers are more likely to postpone trips to specific locations in response to higher fares, or to shop around for those locations offering more affordable fares. Consequently, it is expected that the demand for air transport for leisure reasons will be more elastic than business travel."

For leisure travellers, this means that each incremental dollar of taxes, fees, or charges has a disproportionate impact on the demand for air travel. In addition to the base fare, an additional pass-through charge from airline to passenger for the Backstop will be on top of numerous existing items.

Airlines today face a competitive and dynamic market for product distribution. With the ongoing shift from offline to online travel (applying to direct and via intermediaries like travel agents), consumers today who shop for airfares online typically comparison shop multiple channels such as airline websites, online travel agents ("OTAs") which display prices from multiple airlines, and meta-search travel sites that screen scrape or get direct feeds of airline prices from airline websites and from OTAs for multiple airlines.

Further, consumers can select "nearby" airports. For example, in the case of Vancouver a nearby airport could include Bellingham, WA; for Toronto that could include Niagara Falls, NY and Buffalo, NY; and for Montreal that could include Plattsburg, NY. The point is, with airline pricing fiercely competitive and with consumers able to cross-shop multiple airlines, journeys and nearby airports with the click of their mouse, Canada's trade-exposed commercial aviation sector would be in for an increased rough ride

subject to the Backstop. The rates and applicability of a CORSIA-like scheme would mitigate some of this pain for our country's air carriers.

In addition to effecting lower costs for air carriers from a trade exposure perspective, a CORSIA-like scheme for domestic emissions would help maintain service on marginal routes. The airline sector is, at the best of times, a thinly profitable sector owing high capital costs, many fixed costs in the short run, and a top operational input (fuel) that carries a high price and significant volatility. Added to that is the aforementioned high burden of taxes, fees and other charges imposed on our nation's airlines. The collective impact of the Backstop and the existing cost burden, within the context of a challenging financial business model, could mean that carriers may elect to drop marginal domestic routes should the Backstop be implemented as proposed.

Reduced Administrative Burden

Any carbon pricing instrument applied to domestic Canada intra and inter-domestic flights should be:

a) Compatible and aligned with CORSIA; and

b) Non-duplicative, from an administrative standpoint.

c) Non-duplicative, from an emissions pricing standpoint.

a) Compatibility and alignment with CORSIA

Members of the ICAO Assembly, including Canada, have already agreed to the GMBM CORSIA carbon offset scheme for international aviation emissions. Moreover, the aviation sector strongly endorsed CORSIA and Canada was one of 69 states that agreed to implement the scheme from its outset. With this strong international and Canadian endorsement of CORSIA's methodology pertaining to international aviation, it not only makes sense that Canada follow a similar approach for its domestic aviation emissions, but it must in order to be fully compliant with its obligations under the Agreement.

b) Alignment with CORSIA would be non-duplicative from an administrative standpoint

While domestic flights are beyond the scope of CORSIA, any carbon pricing instrument applicable to domestic (i.e., intra- and inter-jurisdictional) flights should be aligned and made compatible with CORSIA to avoid regulatory fragmentation, to reduce the administrative burden for operators and governments, and to minimize potential market distortions.

A single GMBM to address CO2 emissions from international aviation is favoured by industry participants. Many airlines fly into dozens of different countries on a daily basis, with some large airlines serving over a hundred different countries each day; they need to have a single point of accountability. If airlines are subject to a patchwork of national or regional CO2 taxes, offsetting mechanisms, emissions trading schemes and other carbon pricing instruments, compliance would be unnecessarily complex and costly.

Similarly, NACC is concerned that if domestic and international flights within and beyond Canada are subject to different regimes, the administrative complexity and regulatory burden will be unreasonably high for airlines operating in this country.

The safe, orderly and efficient functioning of today's air transport system relies on a high degree of uniformity in regulations, standards and procedures. While Canada's aviation emissions from domestic operations cannot be part of CORSIA specifically, it would be completely appropriate for any Canadian pan-national program to mirror the CORSIA scheme.

c) Alignment with CORSIA would be non-duplicative from an emissions pricing standpoint

NACC is concerned that the imposition of carbon pricing on inter-jurisdictional domestic flights could potentially lead to duplicate (double or multiple) taxation. For example, on flights between/over two or more provinces such as Halifax to Calgary, a single flight would potentially be subject to carbon pricing in multiple provincial jurisdictions (i.e. in Nova Scotia, New Brunswick, Quebec, Ontario, Manitoba, Saskatchewan, and Alberta), whether topped up by the Backstop to the national carbon pricing standard, or where the Backstop acts wholly in lieu of a provincial carbon pricing scheme. Such double or multiple taxation would be contrary to Canada's obligations as a signatory to CORSIA and would result in undue financial and administrative costs to airlines and their passengers, which would be directly counter to the principles of efficient and fair taxation.

The Canadian Government has not explicitly stated that there will be no duplication or overlap between federal and provincial carbon pricing efforts. For example, the Technical Paper on The Federal Carbon Pricing Backstop, released this year by Environment and Climate Change Canada ("ECCC"), discusses inter-jurisdictional treatment and its likely potential inclusion under the Backstop. While it could be inferred from this text that the Backstop will drive a single carbon price for inter-jurisdictional flights, it does not explicitly rule out duplication.

> "To date, provinces that have introduced carbon pricing systems have either not covered GHG emissions from aviation fuels at all or not applied the carbon price to aviation fuels used in interjurisdictional flights within Canada. The Government recognizes that this exemption may have been made to address competitiveness concerns for local airports. **The introduction of carbon pricing in all Canadian provinces and territories eliminates these inter-jurisdictional competitiveness concerns and presents an opportunity for this important source of GHG emissions to be covered across Canada.** The federal government will engage with provincial and territorial governments and stakeholders to ensure that this emission source is properly covered, through a consistent national approach, and to determine which role the backstop should play in this regard, including in jurisdictions that have a carbon pricing system in place".

A CORSIA-like output-based regime applied on a pan-Canadian basis would eliminate potential duplication on pricing domestic emissions by harmonizing emission thresholds on a pan-national basis. Similar to CORSIA's international structure, NACC envisions a scheme whereby aircraft operators would purchase emission unit offsets for growth in CO2 emissions above some pre-determined level (or

“floor”) for domestic Canada aviation operations. That floor could be aligned with CORSIA’s international departure point, which has been set at the year 2020.

An Offset Scheme Will Deliver Real Carbon Reductions

NACC strongly believes that a pan-Canadian output-based carbon offsetting system compatible with CORISA will deliver real, measurable carbon emission reduction benefits for the environment, while carbon taxes, in contrast, will not.

Compared to carbon taxation, offsetting carbon emissions guarantees a higher degree of environmental integrity.. Provided adequate quality criteria are implemented, each emission unit surrendered in a CORSIA-like scheme will, in effect, deliver an equivalent reduction in carbon emissions. In contrast, there is no guarantee that for each ton of carbon taxed – through the backstop and any other carbon tax – there will be a tangible reduction in carbon emissions.

As well, there is no linkage between hard targets or thresholds, and the carbon taxation of the Backstop – this will further undermine the Backstop’s effectiveness.

Canada’s Working Group on Aviation Emissions did align the Action Plan’s targets with the 1.5 percent fuel efficiency goal committed in the aviation sector’s Global Framework, and with the 2 percent aspirational goal set by ICAO through year 2050. However, the Pan-Canadian Framework, the Benchmark and the Backstop do not set any specific thresholds or goals for Canada’s aviation industry. Unlike CORSIA, the Backstop does not link carbon taxation with any pre-determined emissions threshold. As such, once implemented the backstop will simply become another general tax that gets passed on directly to consumers.

Under CORSIA, aircraft operators will need to purchase offsets for international CO2 emissions growth above quantifiable, year 2020 levels. Because of the economic interconnectedness of the aviation ecosystem it can be argued CORSIA creates an incentive for systemwide efficiencies be they technological, operational and/or infrastructure related.

It is worthwhile to note that Canadian air carriers and related industry participants have already been investing heavily in technology, operational efficiency and infrastructure. The results of these investments and efforts have been proven out. For example, the 2016 Annual Report on Canada’s Action Plan shows that flight operations from Domestic and International aviation posted a 1.73 percent decrease between 2008 and 2016 for both fuel efficiency and carbon dioxide equivalent emissions. The Annual Report further notes that “compared with 2015, Canadian air carriers” [in 2016] “improved fuel efficiency by 3.2 percent”.

CONCLUSION

The policy framework for pricing carbon emissions from air transportation reflected in this Bill fails in three principal ways:

- IT FAILS CANADA'S INTERNATIONAL OBLIGATIONS - It does not reflect Canada's international commitments and obligations under the 2016 CORSIA Agreement, notably with respect to the development of ancillary programs and strategies – such as the commercialization of biojet –to help further reduce aviation carbon emissions
- IT FAILS TO PROTECT CANADIAN INDUSTRY AND TRAVELLERS - While it recognizes the negative impact of a carbon tax on the competitiveness and overall trade exposure of certain sectors, it fails to recognize that commercial aviation in Canada, by virtue of geography (close proximity to the United States) as well as its external cost structure (taxes, fees, etc.), and the high price sensitivity of demand, is also trade exposed. In addition to systemwide economic impacts of such trade related commercial leakage, the emission leakage that would ensue would run counter the goals of Canada's policy in this area.
- IT FAILS AS AN ENVIRONMENTAL MEASURE – In addition to resulting in emission leakage, a carbon tax would do nothing to curb emissions over the medium term. Commercial aviation is a technologically mature sector, the fruit of decades of massive investments in technology and operational systems. This means that over the medium term, it will not be possible to incentivize technological breakthroughs. As we have shown, a carbon tax on aviation fuel would have the effect of dampening domestic demand – including by driving traffic to US carriers – but unless airline load levels fell to the point that individual routes were no longer practicable – **in other words, unless it resulted in service cancellations** -- it would have no impact on overall emission levels.

The National Airlines Council of Canada therefore recommends that the *Greenhouse Gas Pollution Pricing Act* be amended to reflect the specific circumstances of Canada's commercial airline industry by extending in it the possibility for the industry to opt into an output-based carbon pricing approach.