The Invisible Industrial Carbon Tax

Making Sense of Industrial Carbon Pricing in Canada

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Friends of Science Society

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MAKING SENSE OF INDUSTRIAL CARBON PRICING IN CANADA

EXECUTIVE SUMMARY

On March 14, 2025, his first day as Prime Minister of Canada, Mark Carney ordered the suspension of the federal fuel charge. He left unchanged the other components of the federal government's "carbon pricing system", including notably the Output-Based Pricing System (OBPS), generally known as the industrial carbon tax.

On December 11, 2025, the House of Commons Committee on Environment and Sustainable Development held a meeting to hear witnesses testify concerning industrial carbon pricing. The main witness was the Hon. Julie Dabrusin, Minister of the Environment, Climate Change and Nature. David Bexte, Member of Parliament for Bow River, Alberta asked Minister Dabrusin what the anticipated federal government "take" from the OBPS would be every year. The Minister said that the revenues collected from the tax "goes back to the province or the jurisdiction where it's collected, and then that is often paid back to industries", and "it does not go to federal coffers". That exchange largely misses the point about the problems with the OBPS.

The OBPS system is extremely complex. It is balkanized across Canada The balkanized system is governed by the *Pan-Canadian Approach to Pricing Carbon Pollution* (known as the federal benchmark) which sets stringency criteria that all provincial and territorial industrial carbon pricing systems must meet. A facility is not subject to carbon pricing for GHG emissions below an intensity benchmark, which measures emissions per unit of output. Emissions above the benchmark give rise to compliance obligations, which may be satisfied either by paying a carbon price - which follows the same schedule as the federal fuel charge – or surrendering emissions credits purchased from others. It thus includes at least three components, a carbon price, an emissions intensity standard, and an emissions trading feature. In most jurisdictions, the funds raised as a result of the system must be spent on emissions-reduction projects or investments. They are not returned to taxpayers through refunds or made available for investment in projects justified by their economic merits.

The most up-to-date information available concerning the revenue raised by federal and provincial OBPS systems indicates that they are in the range of $2 billion per year. The Public Accounts of Canada indicate that the "excess emission charges" in the federal government system alone totaled $301 million in 2022-23, $225 million in 2023-24 and $15 million in 2024-25.

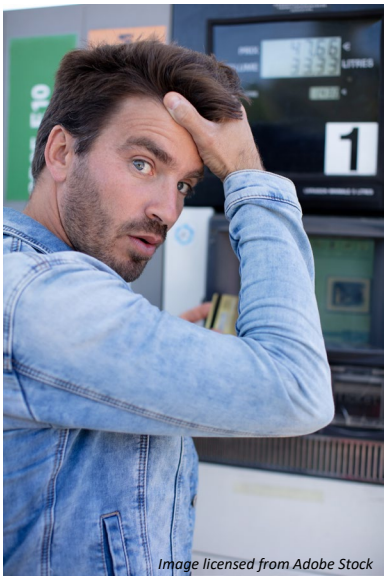
Environment and Climate Change Canada recently published a discussion paper in which it outlined perceived problems with the current OBPS system, including a proposal to modify the required coverage of the system to include smaller emitters (those emitting under 10,000 tonnes per year for conventional oil and gas activities). It is not clear how, if at all, these considerations would be affected by the recently-signed memorandum of understanding between Canada and Alberta. The timing is strange.

Many Canadians think that the carbon tax has been eliminated. They are unaware of the complexity and cost of the carbon pricing regime imposed on Canadian firms, of the magnitude of the costs and of the misallocation of resources it causes. The Carney government's move to make the OBPS even more costly and restrictive may draw attention to what is really happening.

MAKING SENSE OF INDUSTRIAL CARBON PRICING IN CANADA

THE INVISIBLE INDUSTRIAL CARBON TAX

On March 14, 2025, his first day as Prime Minister of Canada, Mark Carney ordered the suspension of the federal fuel charge. This is known more often as the carbon tax. He left unchanged the other components of the federal government's "carbon pricing system", including notably the Output-Based Pricing System (OBPS).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The OBPS and its counterpart in the Quebec cap and trade system are the carbon taxes imposed on large industrial emitters. The Quebec cap and trade system is integrated with California's cap and trade system and has been deemed by the federal government to satisfy Canada's requirements for carbon pricing. British Columbia has its own carbon tax with a similar scope and rate schedule as the federal fuel charge. Not formally part of the carbon pricing system but closely related in intent and effect are the *Clean Fuel Regulations*. The *Clean Fuel Regulations* require that primary fuel suppliers of gasoline and diesel fuel (i.e. refiners and importers) reduce the carbon intensity of supplying the fuels by roughly 15% below 2016 levels by 2030. **The Fraser Institute estimates that these regulations will raise gas prices by up to 17 cents per litre by 2030.**

Carney's suspension of the federal fuel charge reduced it from **$80 per tonne to zero**, and if continued indefinitely would pause the previously-announced federal government plan to **raise the fuel charge to at least $170 per tonne by 2030.** The OBPS is often referred to in the media as the "industrial carbon tax".

HOUSE OF COMMONS REVIEW

On December 11, 2025, the House of Commons Committee on Environment and Sustainable Development held a meeting to hear witnesses testify concerning industrial carbon pricing. The main witness was the Hon. Julie Dabrusin, Minister of the Environment, Climate Change and Nature. The record of the committee hearing can be read here.

David Bexte, Member of Parliament for Bow River, Alberta asked Minister Dabrusin what the anticipated federal government "take" from the OBPS would be every year. The Minister said that the revenues collected from the tax "goes back to the province or the jurisdiction where it's collected, and then that is often paid back to industries", and "it does not go to federal coffers". There followed several give and take exchanges in which Minister Dabrusin declined to give any numbers as to how much the OBPS raised in revenues.

That exchange largely missed the point about the problems associated with the OBPS.

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OBPS DESIGN AND FEATURES

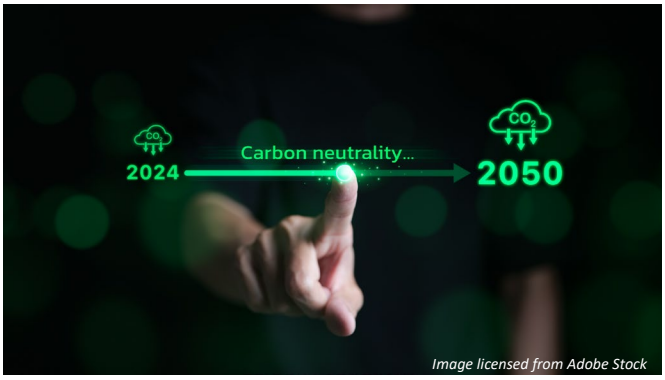
The following is the AI-generated explanation of the system.

"*The Output-Based Pricing System is the federal carbon pricing mechanism in Canada for large industrial emitters (facilities typically emitting over 50,000 tonnes of CO2 equivalent per year, with opt-in options for smaller ones). It applies in jurisdictions without equivalent provincial systems meeting federal benchmarks…Facilities exceeding their emissions intensity limits pay an excess emissions charge (aligned with the federal carbon price schedule), generating proceeds. These proceeds are returned to the jurisdiction of origin, often via the OBPS Proceeds Fund for decarbonization projects, clean technology, and electricity grid improvements (e.g. through programs like the Decarbonization Incentive Program).*

Unlike the fuel charge (which applies to consumers and fuels), OBPS revenues are relatively modest because the system is performance-based: many facilities earn surplus credits, or meet limits without paying charges, and compensation can also come via credits/offsets rather than direct payments.

The following features add to the complexity of the OBPS system:

- It is balkanized across Canada. There is a federal regime in Prince Edward Island and the territories, but Alberta, British Columbia, Ontario, Saskatchewan, New Brunswick, Newfoundland and Labrador and Nova Scotia run their own systems. These systems vary considerably in size;
- The balkanized system is governed by the *Pan-Canadian Approach to Pricing Carbon Pollution* (known as the federal benchmark) which sets stringency criteria that all provincial and territorial industrial carbon pricing systems must meet. Notably, the main criteria in the benchmark include the annual minimum national carbon price for excess emissions (currently set for 2023 to 2030), a minimum common scope of GHG emissions that all systems must cover, and requirements that systems must maintain the carbon pollution price signal on all the GHG emissions they cover by not implementing measures that offset or reduce the price signal.
- The federal benchmark system has multiple objectives, some of which are contradictory. It seeks to increase the cost of emissions by regulations that force reductions in the allowed level and limiting the amount of permits that are available for trading. It claims to protect against carbon leakage (i.e. imposing costs so high that they drive emitting companies to other jurisdictions). Finally, it seeks to ensure that Canadian industry invests in low-carbon technologies and practices.
- A facility is not subject to carbon pricing for GHG emissions below an intensity benchmark, which measures emissions per unit of output. The benchmark, in theory, is set by a regulatory agency at the level of the "best available abatement technology", but it is unclear whether all jurisdictions use the same standard or apply it in the same ways.
- Emissions above the benchmark give rise to compliance obligations, which may be satisfied either by paying a carbon price - which follows the same schedule as the federal fuel charge – or surrendering emissions credits purchased from others. It thus includes at least three components, a carbon price, an emissions intensity standard, and an emissions trading feature.
- In most jurisdictions, the funds raised as a result of the system must be spent on emissions-reduction projects or investments. They are not returned to taxpayers through refunds or made available for investment in projects justified by their economic merits.



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THE COSTS OF THE SYSTEM

In Canadian policy debates, there tends to be a presumption that carbon pricing is the most economically-efficient way to reduce GHG emissions, but the Canadian regime differs greatly from the theoretical ideal[1]. Among other problems, no ready evaluative framework for the OBPS has been put forward. In one excellent article, the flaws in the current OBPS were explained at length, but by comparing the regime to the theoretical carbon pricing ideal, not to any other regime actually in practice. That article presents the most up-to-date information available concerning the revenue raised by federal and provincial OBPS systems, indicating that they are in the range of $2 billion per year. The Public Accounts of Canada indicate that the "excess emission charges" in the federal government system alone totaled $301 million in 2022-23, $225 million in 2023-24 and $15 million in 2024-25.

Two billion dollars per year for all governments is not a negligible sum, but is small compared to the total "pollution pricing proceeds" of $15.6 billion in 2024-25 reported in the federal government's Consolidated Statement of Operations and Accumulated Operating Deficit.

Aside from the financial costs of the OBPS system for the firms covered, there are important but rarely unmeasured economic costs. **Canadian firms subject to the carbon pricing regime are placed at a competitive disadvantage whether in domestic or export markets**. **They pay twice, initially to incur the capital and operating costs associated with reducing emissions and then to pay the permit costs for the "excess" emissions. Nowhere can one find an accurate estimate of the two sets of costs.** The money firms pay would otherwise be available to be invested in economically appealing equipment and machinery in Canada. Instead, it must be spent on "green" projects of lesser economic value. This marks a significant misallocation of otherwise productive resources.

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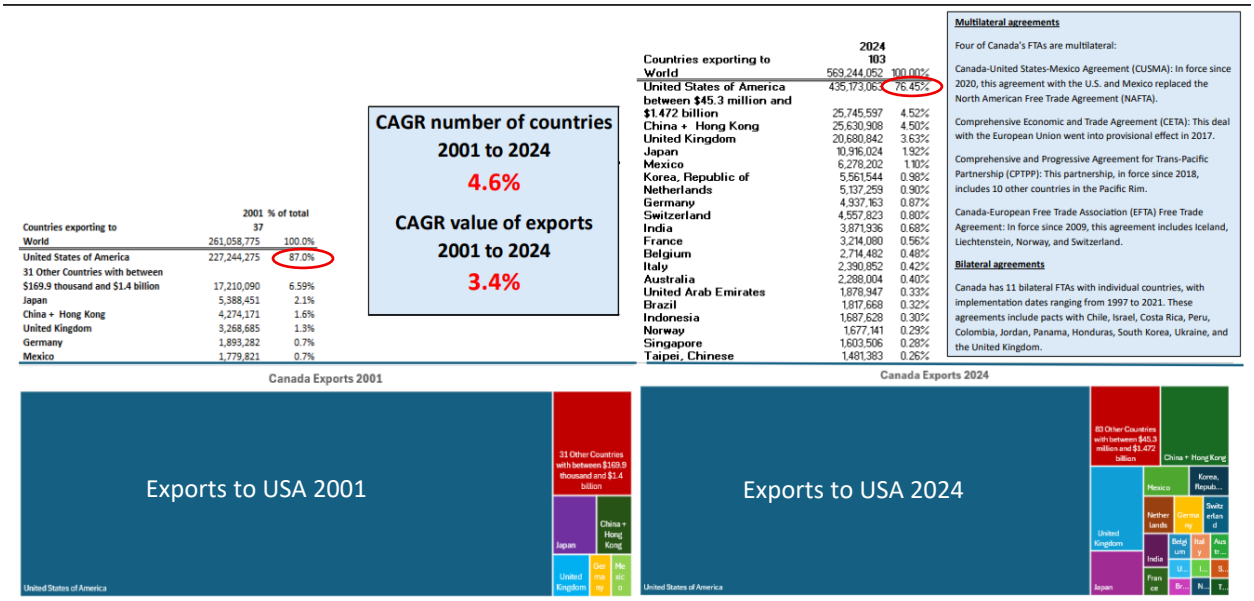
Firms, of course, cannot absorb the costs indefinitely, especially when they must compete with suppliers in other jurisdictions that do not bear the same regulatory and cost burdens. Where competitive conditions permit, they

[1] Robert Lyman, *Carbon Taxation: The Canadian Experience*. Global Warming Policy Foundation, June, 2019

pass the costs on to consumers through higher prices for their products. The mechanisms of cost-passthrough are higher prices in the supply chain, higher costs of production and higher costs of transporting goods to market. The burden of the resulting higher prices often falls heaviest on people with lower or fixed incomes. There have been only a few studies done on the magnitude of the impacts on consumers. These generally tend to assess the costs so far as modest, especially when considered in the context of other inflationary pressures.[2] Those costs, however, will only increase as the rate of the federal fuel charge rises to $170 per tonne in 2030 and perhaps $300 per tonne or higher after that.



Source: https://blog.friendsofscience.org/2025/10/17/facts-on-canadas-global-trade-an-open-letter-to-senior-deputy-governor-carolyn-rogers/

Proponents of industrial carbon taxes sometimes argue that Canada needs them to avoid being penalized when exporting to countries that have implemented a Carbon Border Adjustment Mechanism (CBAM), which is like a tax meant to offset the difference between the carbon tax costs borne by domestic and foreign suppliers. However, Canada's major trading partners (the United States, China and Mexico), do not have industrial carbon pricing regimes. The European Union (EU) is the only jurisdiction with a fully active CBAM. The EU accounts for only 8% of Canada's export trade. Other countries (e.g. the United Kingdom, Japan, South Korea, Australia) are considering implementing similar measures but must work their way through the controversies involved in doing so. It remains to be seen how the jurisdictions with CBAMs will be able to cut through the complexity of the Canadian OBPS system to determine how large an import tax to apply. Further, one also can only speculate about how the Trump Administration in the United States will respond to the CBAMs imposed by some countries on US exports. The reaction seems unlikely to be favourable.

[2] Trevor Tombe, Jennifer Winter. *Does Emissions Pricing Hurt Affordability? Quantifying the Effects on Canadian Households.* Institute for Research on Public Policy, December, 2024

PROPOSED CHANGES IN THE OBPS SYSTEM

Environment and Climate Change Canada recently published a discussion paper in which it outlined perceived problems with the current OBPS system and set out some possible changes about which it will seek stakeholder feedback. The initial reaction from industry has been wary, especially to the news that the federal government proposes to modify the required coverage of the system to include smaller emitters (those emitting under 10,000 tonnes per year for conventional oil and gas activities). It is not clear how, if at all, these considerations would be affected by the recently-signed memorandum of understanding between Canada and Alberta. The timing is strange.

CONCLUSION

Many Canadians think that the carbon tax has been eliminated. They are unaware of the complexity and cost of the carbon pricing regime imposed on Canadian firms, of the magnitude of the costs and of the misallocation of resources it causes. The Carney government's move to make the OBPS even more costly and restrictive may draw attention to what is really happening.

ABOUT THE AUTHOR

Robert Lyman is an economist with 27 years of experience as an analyst, policy advisor and manager in the Canadian federal government, primarily in the areas of energy, transportation, and environmental policy. He was also a diplomat for 10 years. Subsequently he has worked as a private consultant conducting policy research and analysis on energy and transportation issues as a principal for Entrans Policy Research Group. He is a frequent contributor of articles and reports for Friends of Science, a Calgary-based independent organization concerned about climate change-related issues. He resides in Ottawa, Canada. Full bio.

ABOUT FRIENDS OF SCIENCE SOCIETY

Friends of Science Society is an independent group of earth, atmospheric and solar scientists, engineers, and citizens that is celebrating its 23rd year of offering climate science insights. After a thorough review of a broad spectrum of literature on climate change, Friends of Science Society has concluded that the sun is the main driver of climate change, not carbon dioxide (CO2).

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