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THE IMPLICATIONS TO COMPETITIVENESS AND SUSTAINABLE DEVELOPMENT OF ENVIRONMENTAL COST-RECOVERY INITIATIVES OF THE CANADIAN FEDERAL GOVERNMENT

Prepared for:

Environmental Affairs Branch
Industry Canada
Ottawa, Canada

Prepared by:

Cowan Research Inc.
Toronto, Canada

March 31, 1998

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Preface

This study, by Cowan Research Inc., was undertaken to assess, in a preliminary way, the impacts upon sustainable development and industrial competitiveness in Canada of several cost recovery exercises in the environmental field that are currently underway within the federal government.

The objective of cost recovery, as outlined in the Treasury Board policy on cost recovery, is to recover the costs to government of providing goods and services, or delivering programs, that confer direct benefits to individuals or businesses beyond those received by the general public. The economic rationale for user charges is to improve the efficiency with which government departments and agencies make use of available resources. Some recent applications by departments of this policy have generated opposition and criticism from affected segments of industry.

Mr. Cowan was engaged to conduct a limited survey, primarily of industry officials directly impacted by environmental cost recovery initiatives. The intent of these interviews was to learn about the concerns of those directly affected by the initiatives and to identify the issues that they saw as important. The key conclusions of the study (which, of course, are those of the consultant and not necessarily those of Industry Canada or the federal government) are:

- most environmental cost recovery initiatives at the federal level are not designed to recover large amounts of money and, therefore, are not in themselves having significant adverse competitiveness impacts upon industry as a whole -- nevertheless, some sectors, and individual firms within them, may see their marketplace competitiveness impacted;

- consultations surrounding some cost recovery initiatives have been lengthy and expensive for both industry and government, suggesting the possible need for a *de minimis* threshold for such exercises;

- industry has also expressed concern that some environmental cost recovery exercises have provided inadequate opportunity to properly examine how to re-engineer the regulatory regime so as to reduce costs of administration;

- part of the controversy surrounding cost recovery has its origin in the fact that, when there are mixed public-private benefits in a regulatory regime, there are no agreed upon methodologies for objectively "teasing out" the private benefit and recovering for it alone;

- high regulatory hurdles, compounded by cost recovery, may have the effect of keeping new, more environmentally friendly products out of the Canadian market.

Not surprisingly, when it was reviewed interdepartmentally, the Cowan study itself was controversial. As the appended comments of reviewing departments make clear, they believe that there are factual errors and methodological shortcomings in the study, plus an excessive reliance upon anecdotal evidence. Because affected departments took strong exception to Mr. Cowan's findings, their responses are published as a part of the Cowan report.

Departments implementing cost recovery are aware of the concerns of industry and are doing their best to have cost recovery proceed on a consensual basis. It is the hope of Industry Canada that this report will provide constructive input to the ongoing consultations that accompany the initiatives. It should also help to set the stage for the three-year review of the federal *Cost Recovery and Charging Policy* that is planned by the Treasury Board Secretariat.

Executive Summary

Project Purpose

to review the Federal government's cost-recovery and user-charges initiatives to determine:

- the industrial competitiveness effects of these initiatives; and
- whether the cost-recovery initiatives support or conflict with the government's sustainable development goals.

Approach

Six initiatives were examined: the *Marine Oil Spill Response Organizations* (ROS); the *Pest Management Registration Agency (PMRA);*; the *New Substances Notification* regulations (NSN); the *Trans-Boundary Movements of Hazardous Wastes* regulations (TBM); the *Ocean Disposal* regulations (OD); and *Environment Assessment* regulations(EIA). Existing research reports were reviewed and follow-up research was carried out with individual companies, sector associations and agencies implementing cost-recovery.

Conclusions and Recommendations

- Implementation of cost-recovery has been contentious. Ministers are getting dragged into the details of their own Department's initiatives, and those of other Ministers..
- Ministers will continue to be lobbied extensively on cost-recovery programs. Implementation will continue to be controversial. The amount of money being recovered, for many of the programs, is very small.

- The issue of deciding whether regulatory programs provide public or private benefits, and how much of each, is a stumbling block to implementation. The Treasury Board policy provides no practical guidance on how to address the issue. The government should provide more guidance to agencies before cost-recovery initiatives are implemented, to reduce the pressure being put on individual Ministers.
- These cost-recovery programs affect industrial competitiveness in two ways:
    - directly, by imposing fees and charges that are not paid by major international (particularly the US) and domestic competitors. The ROS and TBM programs are examples of this effect; and,
    - indirectly, by aggravating an already-disadvantaged situation caused by more costly Canadian regulations than those in competitors' countries. This applies particularly to the PMRA and NSN programs.
- Industry believes that a further effect of the more-costly regulatory approach in the cases of PMRA and NSN is to keep new, environmentally-better substances out of the Canadian market. If so, sustainable development is being compromised. Cost-recovery will accentuate the problem
- In some cases, there is evidence to support the above points. In others, it is difficult to extricate the incremental effect of the more-costly Canadian regulations on competitiveness. This is a common difficulty.
- The cost-recovery goal has prevailed over that of sustainable development, in part, in two of the programs (ROS and TBM). The new governance system to be developed for marine oil spill responses should balance the goals of sustainable development, industrial competitiveness and financial viability.

The *Trans-Boundary Movement* program costs should not discriminate unduly against recyclables.

- Of the five cost-recovery programs examined that remain within government, only one (*Environmental Assessment*) contained significant cost-reduction approaches. Four did not. Without such changes, there will be no increase in the efficient use of scarce public resources, as called for in the Treasury Board's cost-recovery policy. It is only the affected industries who are making the difficult adjustments to the new costs of doing business. The cost-recovery agencies are similar to unregulated monopolies: they face no commercial pressures to reduce costs or increase services, no competition is allowed and there are no limits to future fee increases or to arbitrary changes in service levels.
- The *Environmental Assessment* cost-recovery initiative should serve as a model. It contains all of the elements required in the cost-recovery policy.
- Three of the cost-recovery initiatives (TBM, OD, NSN) represent large expenditures of public and private resources on consultation, studies etc. extending over several years. The total amount of money to be recovered by all three programs is less than $3 million annually.
- The recent introduction into the House of proposed changes to the *Canadian Environmental Protection Act* presents an opportunity to air thoroughly the issues of the effects on Canadian industrial competitiveness of regulatory approaches such as NSN and PMRA. It might be appropriate to postpone implementation of cost-recovery on these programs until the hearings have taken place and new environmental policy directions are set.

1. THE COST-RECOVERY POLICY OF THE FEDERAL GOVERNMENT

User charges for federal government services have been around for many years. A recent count by the Office of the Auditor General for Canada (OAG) listed 41 Federal departments and agencies collecting about $3.8 billions in user fees[1] for fiscal 1995-96, about a 7% increase over the previous year. Transport Canada, the Royal Canadian Mounted Police and National Defence represented about 60% of this total, leaving 38 Departments and Agencies to share the remaining 40%.

What has changed recently, though, is the public profile attached to the Federal government's efforts to widen the application of cost-recovery. Cost-recovery is being applied to a widening circle of services, and it is generating considerable controversy. Ministers are being forced to devote time to reconciling on-going conflicts within their own cost-recovery initiatives, and those of other Ministers.

The rationale for the new user fees is increased economic efficiency. The new cost-recovery policy produced by the Treasury Board in 1997 (replacing the 1989 policy) states:

"....more attention must be paid to who receives benefits from government activities and whether it is reasonable for Canadians in general to continue to pay the full cost in cases where direct benefits accrue to specific individuals or

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[1] Inventory Of User Fees, annex in *Information Booklet on Cost Recovery and User Fees*, OAG workshop, July 1997

organizations. The economic rationale for levying user charges is to improve the efficiency with which departments and agencies make use of available resources...."[2]

Careful reading of the policy shows that the improvement in efficiency was to come about through the use of appropriate costs and prices. Once prices reflected true costs and benefits derived, then resources (both public and private) could be allocated more efficiently.

Most of the industry representatives affected by the cost-recovery initiatives start out agreeing with those principles. Who could argue with increased government efficiency, in a time of reducing budgets and wars on deficits and debts? Especially since, as we will see later in this report, the policy document stresses the need for cost-reduction and rationalization to go hand-in-hand with cost-recovery.

The details of implementation, however, have been difficult and controversial. Several court challenges to Federal cost-recovery and user- fee initiatives have been pursued, and others have been considered. Ministers, Parliamentarians, the media have all gotten into the fray. The OAG became interested in the topic as a result of the controversy, and held an in-house workshop on cost-recovery in July 1997 to begin to determine if there were issues that that Office should examine. Numerous industry and business interest groups such as the Canadian Chamber of Commerce, the Business Council on National Issues, etc. have made their concerns known to the government and Ministers.

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[2] *Cost-Recovery and Charging Policy*, Treasury Board of Canada, April 8, 1997

Typically, the negotiations concerning a cost-recovery initiative can drag on for several years. The costs of the required studies, cross-country meetings, program disruptions, etc. are seldom reckoned, but they have been significant.

Several of the recent cost-recovery initiatives have been in the areas of sustainable development and environmental protection. Many of the initiatives, directly or indirectly, affect industrial competitiveness. Both sustainable development and industrial competitiveness are legitimate interests of the Department of Industry Canada. This study was commissioned to examine the implications of the cost-recovery initiatives from the perspectives of sustainable development and industrial competitiveness.

2. PURPOSE, METHODOLOGY AND REPORT FORMAT

Purpose

The purpose of this project is to review the Federal government's cost-recovery and user-charges initiatives that affect the sustainable development and industrial competitiveness goals of the government and to determine, if possible:

- the individual and cumulative industrial competitiveness effects of these initiatives; and
- the extent to which the cost-recovery initiatives and their effects support or conflict with the government's sustainable development goals.

Note that the purpose is not to review the cost-recovery policy itself; rather, it is to review the practical implications on sustainable development and competitiveness of the implementation of the government's cost-recovery and user-charges policy.

Methodology

We began by identifying the cost-recovery and user-fee initiatives that we believed could affect sustainable development and industrial competitiveness, and that represented the range of initiatives being introduced. We focused on those initiatives that affected Canadian industry in the name of environmental protection or sustainable development explicitly.

Seven initiatives were examined:

- *Pest Management Registration Agency* (PMRA);
- the *New Substances Notification Program* (NSN);
- *Trans-Boundary Movements of Hazardous Wastes* (TBM), also referred to as the Export-Import of Hazardous Wastes Regulations;
- *Environmental Assessment* (EA);

- *Ocean Disposal of Wastes* (OD);
- *Marine spill Response Organizations* (ROS); and,
- a special case study around the experience of one large company.

The original intent was to focus on a smaller number of these cases, selecting those which had the most relevant information. In the end, we decided to report on all of the situations, with the exception of the last one. The company's experiences were better presented under the discussions of the individual cost-recovery initiatives.

We relied, generally, on existing information to document the history and issues surrounding the cost-recovery initiatives. When appropriate, we augmented this fact-finding with follow-up discussions and research with firms and industries that had been, or will be, affected by the costs.

Report Format

The remainder of this report consists of 4 sections which flow as follows:

Section 3. Current And Planned Environmental Cost-Recovery Initiatives
lists and presents summary information on the initiatives that we have reviewed and the latest information available on any new cost-recovery initiatives;

Section 4. Industry Issues
describes the main problems with the cost-recovery initiatives from the perspective of the affected industries;

Section 5. Case Studies of Cost-Recovery And Sustainable Development
presents the results of the reviews of the cost-recovery initiatives; and,

Section 6. Conclusions and Recommendations

presents our conclusions on the effects of the cost-recovery initiatives on both industrial competitiveness and sustainable development, and several recommendations.

3.CURRENT AND PLANNED COST-RECOVERY INITIATIVES

Summary facts on the selected initiatives are presented in the following table.

NAME	DEPT.	PROPOSED ANNUAL CHARGE ($ mm)	YEAR TO START	SECTORS AFFECTED?	STATUS
New Substs. Notific.	Env. Can./ Health Can.	$0.8 (of $3.5)	expected Aug. '98	*directly*: chemical *indirectly*: all mfg.	final stages of consultation, design, impact analysis
PMRA	Health Can.	$12 (of $27)	April, 1997	agric., chemical mfgs.,	Board approved charges for one year only; independent review started
Trans-Bound. Moves.	Env. Can.	$1.4 (of $2.8 for Env. Can only)	expected late '98	haz waste imps/exports; recyclers	to go to Board within one month
Environ. Assessme.	Env. Can	about 65% of panel review cost	when approved	mining, hydro forestry;	submitted to Board Dec./97
Ocean Disposal	Env. Can.	$0.8 (of $1.2)	late '98	Ports, forestry, shipping, mining, govt.	to go to Board within one month.
Oil Spill Response Organizs.	Coast Guard	to be determined	uncertain	ships./carriers of petr. products; Many others because of benchmarks	Unresolved for 1.5 years; Minister's decision expected by April 30/98

Treasury Board officials informed us that there are no new cost-recovery initiatives planned for fiscal year 1998/99.

4. INDUSTRY ISSUES WITH COST-RECOVERY

Most of the affected industry representatives have ended up resisting the cost-recovery programs, despite starting out professing support for the goals of less and more efficient government. The objections to the charges can be grouped into four headings:

- The *competitiveness impacts* of the individual charges and of the accumulation of the charges;
- Resistance to *paying for what is seen to be a public benefit*;
- Cost-recovery *working against sustainable development*; and
  Cost-recovery becoming just revenue generation, a way of avoiding cuts in budget allocations, *with no limits on future cost increases* ("unregulated monopolies").

We discuss these issues below, and then illustrate them with the case studies in the next section.

competitiveness impacts

At least four of the six cost-recovery initiatives will levy charges in situations that may affect the competitiveness of Canadian firms in the marketplace. The four are: the Response Organizations (ROS), NSN, PMRA and TBM.

The Canadian firms will be required to pay charges that their competitors (mainly American) do not have to pay or, in the case of the ROS, that some Canadian competitors will not have to pay. In businesses with slim margins, these charges can make a difference. In the case of the ROS, PMRA and NSN, the effects could be felt by sectors beyond those paying the immediate costs. The companies affected by the TBM initiative have raised the additional point that the charges

might not be in compliance with NAFTA.

A concern has been the lack of attention paid by the agencies implementing cost-recovery to the cumulative impact of multiple federal and provincial cost-recovery programs. There have been few attempts to add up the cumulative effects of the federal cost-recovery programs, let alone the provincial programs. When you have to pay both fees, it is of little comfort to be reminded that the Federal government has no control over Provincial initiatives (and vice versa). The Treasury Board policy explicitly states that cumulative impacts are to be considered. In practice, they seldom have been.

public vs. private benefits

In each initiative there has been discussion over whether private industry should be paying for what is seen, by the affected industries, to be a public benefit. This question arises particularly when industries are complying with mandatory regulations intended, in part, to protect the public from activities that pose risks (for example NSN, PMRA and the TBM). The questions gets asked: "*Why are we paying for an activity that provides public benefits? Isn't that what our taxes are for?*"

The Treasury Board policy anticipated that distinguishing between public and private benefits would be tricky in practice. The policy document suggests four tests to assess whether a benefit is predominately private or public[3]:

- excludability;
- the effect of charging on demand for service;
- the extent to which a mandatory service conveys direct benefits with respect

[3] *Cost-Recovery and Charging Policy*, Treasury Board of Canada, April 8 1997, Policy Statement, page 7

to marketability, etc.; and

- the relative importance of policy objectives.

These tests are helpful, but most of the cost-recovery programs end up providing a mix of public and private benefits according to the tests.

Typically, the industries have been regulated because of the potential public risks of the for-profit activities that they wish to undertake. The background document on cost-recovery prepared for the Treasury Board Secretariat points out that there are only two groups that can pay for such a program: the general public or the small group of for-profit proponents who are seeking approval to be exempted from the regulations[4]. It is reasonable to expect those who profit from the approved activities to pay at least part of the costs of securing the approval. Not all industry groups have agreed with this point, however. The background paper goes on to state that regulatory programs such as these typically require considerable consultation to ensure that the appropriate charges are being levied.

In practice, most of the cost-recovery consultations end up establishing a split between public and private benefits bestowed by the program, and then using that split to set the proportion of total costs to be recovered. The split is usually an arbitrary figure.

The discussions about the split have been long, difficult and rancorous. The Treasury Board policy provides no guidance on how to determine the appropriate split. Neither does the Treasury Board Secretariat provide leadership to the Departments or regulated groups on how to set the split. The government agencies

[4] *User Charging In The Federal Government: A Background Document*, Treasury Board of Canada, Secretariat, Government of Canada; page 12, last para.

and their affected industries are left to sort out the problem themselves. The discussions become difficult, quickly, especially as each side realizes the practical importance of the cost-recovery targets set. We return to this point later, under the discussion of cost-recovery becoming just revenue generation.

The fourth test for public vs. private benefits, listed above, states that even though a program might meet the technical criteria for cost-recovery, there might be other policy objectives that could act to override the cost-recovery policy[5]. That is, if the program is contributing to policy objectives that are considered to be equally or more important than the cost-recovery objectives, then the application of the policy could be waived or reduced.

The usual overriding policy objective in cost-recovery discussions is redistribution of income or wealth. If so, it can be counter-productive to impose user charges on the program's clients. The user charges merely reduce the amount of wealth that is being transferred. This is not the situation in any of these cost-recovery initiatives.

However, there are other aspects of this question. If, for example, it could be shown that the imposition of a user charge would impede the competitiveness of major industry sectors, or impede the implementation of a policy such as sustainable development, then that could be sufficient reason to reconsider the extent of application of the cost-recovery policy. That leads directly into the next industry issue.

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[5] *Cost-Recovery and Charging Policy,* Statement on page 2, and Reference Note 1 on page 7

Cost-recovery working against sustainable development

Several of the initiatives appear to be working, at least in part, against the goals of sustainable development, in one case by discouraging localized pollution prevention and in the second case by discouraging recycling of wastes.

Industry has argued that the NSN and PMRA regulatory programs work against sustainable development because, according to industry, these programs delay or prevent the introduction of new, more environmentally-friendly, chemicals into Canada.

How can screening processes that are supposed to weed out risky substances, end up preventing environmentally-friendly substances from being introduced? According to the industry, the high costs of complying with Canadian regulations prevent these more-benign substances from being introduced. The Canadian market is a marginal one for the international companies that develop the new substances. The market returns are not always worth the extra costs of complying.

Imposing cost-recovery on these programs makes a bad situation even worse, according to the industry. Now the new, allegedly more-benign, substances must pass a double financial hurdle: the extra costs of complying with Canadian regulations coupled with the new charges levied for the substance to be approved.

Cost-recovery just avoiding painful budget cuts, no limits to increases

This has been one of the most emotion-filled issues in many of the cost-recovery consultations. The Treasury Board policy explicitly states that cost-recovery is not to become just a way of restoring budget cuts, that rationalization and efficiency gains by government agencies are to be integral parts of their cost-recovery

actions[6]. Cost-recovery was expected to help the public sector managers see the true demand for their services, by levying efficient costs in the marketplace.

In practice, it has seldom worked that way. Few of the cost-recovery programs have had significant cost reduction and rationalization plans introduced along with the levying of charges. One agency increased its staff in response to cost-recovery.

The affected industries know that paying the new costs will have effects somewhere on their businesses: retrenchment, job-losses, postponed investments, etc. The agencies implementing cost-recovery realize that failure to meet their revenue targets could mean that they will have to make painful adjustments (lay-offs, etc.) unless the Department finds money from elsewhere to make up the deficit.

The lack of significant cost-reduction actions within cost-recovery initiatives has led industry to view cost-recovery as just a way to generate revenue for government agencies, thus avoiding the painful adjustments required by budget cuts. The affected industries see themselves as the only ones making difficult adjustments to the new costs of doing business.

A further concern is that there are no limits to the cost increases that can be imposed in the future, once cost-recovery has been implemented. The agencies face no competition in the supply of their services, and have none of the normal commercial incentives and pressures to keep their costs low. They are, in effect, unregulated monopolies with no limits on the fees that they can charge and no pressures to improve services.

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[6] *Cost-Recovery and Charging Policy*, Treasury Board of Canada, April 1997, Introduction, Prerequisites, Question #8 and elsewhere.

5. CASE STUDIES

We now report on the case studies of the selected cost-recovery and user-charges programs.

5.1 THE MARINE SPILL RESPONSE ORGANIZATIONS

Background

This initiative it is an example of how government charging initiatives are spreading a wide net throughout the field of sustainable development and industrial competitiveness. It also presents an example of how these initiatives can end up working, at least in part, contrary to the tenets of environmental protection and sustainable development. This program also has serious competitiveness impacts for many segments of Canadian industry.

This initiative has a long, complex history. It goes back almost 10 years to the Brander-Smith report which pointed out that Canada did not have the facilities required to deal with a major marine spill of petroleum products (gasoline, oils, ashpalts, etc.). The government's response got caught up in the trend to *Public-Private Partnerships* several years ago. This led the Canadian Coast Guard (CCG) to withdraw from control of the design of a marine oil spill response capability and associated charges. The CCG called for tenders for organizations to be certified as *Response Organizations* (ROS). These ROS would be given regulatory powers to charge fees on marine shipments of petroleum products to pay for the standby costs of the required capital equipment to deal with major spills.

Note that this was one initiative in which the public-private argument did not arise. It was agreed that the private sector posed the risk, and should take the lead in responding to that risk.

The end result was a set of 5 ROS, consisting of different combinations of the major oil companies, with agreements among the 5 that let them meet the technical specifications for certification. Each of the ROS was responsible for a certain geographical area. The technical requirements imposed by the CCG made it impossible for smaller independent oil handlers, or contractors, to be certified as ROS.

The 5 successful ROS then published in the Canada Gazette their draft contracts and fees that all transporters or shippers of petroleum products would be required to sign, and pay. The protests were immediate and loud.

The ROS were seeking wording that would outlaw competitors in their designated areas, the fee structures worked directly against sustainable development and environmental protection by discouraging localized pollution prevention, and offered the opportunity for other abuses of the monopoly powers that they would be given once the regulations were implemented. In particular, the airlines and others pointed out that the majors would be free to raise artificially the price of domestically refined petroleum products because the price of imported products were the benchmarks against which domestic prices were set. Since some of the imported products would now pay the ROS fees, the benchmarks would be raised. Windfall profits to the domestic majors were estimated to be over $20 millions per year. The competitiveness of entire swaths of Canadian industry would be affected.

Legal challenges against the proposals were initiated by the airlines and independent petroleum shippers and carriers on both coasts and in the Great Lakes. The Government responded by creating a review panel, chaired by Prof. E. Gold of Dalhousie University. The terms of reference for the Gold Panel were also

challenged, successfully, by the affected industries in an out-of-court settlement.

The Gold panel agreed with the concerns of the intervenors. The Panel recommended to the Minister to strike down completely the arrangements with the ROS. The Panel then recommended its own system of charges and arrangements. Major points in the Gold report were that the proposed fee structure was "*unworkable*", "*did not meet even the most basic fairness and equity criteria required by the Canada Shipping Act*"[7], and that the "*...fee structure is not environmentally risk based and, therefore, the fees are unfair and inequitable.*"[8]

It is this last point that is particularly relevant to our interests. The terms of the proposed contracts offered no significant incentives for local pollution prevention at berthing facilities (such as boom facilities) nor in ships themselves (such as double-hulling).

This left the government in a quandary. Pursuant to the *Canada Shipping Act*, the Minister of Fisheries and Oceans must make a decision to approve or amend the proposed ROS fees. The Panel's recommendations presented a dramatically different approach. Some of the Panel's recommendations were based on personal beliefs, rather than the result of careful analysis. It was difficult to pick and choose among the Panel's recommendations, since they were inter-related.

The situation has been uncertain now for almost two years. The fees have not received the Minister's approval and therefore, in the minds of the objectors, are not legal. Yet some of the ROS are attempting to insist on receiving the fees before

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[7] *Canadian Oil Spill Response Capability: An Investigation of the Proposed Fee Regime*, Final Report, August 1996, page ii

[8] ibid., page 59 "*The Fees Are Not Risk Related*"

they will allow independents to use their berthing facilities. Some objectors report that there have been threats to seize ships. On the other hand, those companies that have agreed to pay the ROS fees claim that those not paying are receiving windfall benefits. The situation is tense.

We understand that the Minister of Fisheries and Oceans will be making an important announcement on this before the end of April 1998. He will likely announce an interim arrangement, to serve while a better approach to governance, appeals, fairness, equity etc. is considered.

Update On Effects

The concerns about discouragement of localized pollution prevention have proven to be correct. The ROS' concern about protecting their revenue streams prevailed over localized sustainable development and environmental protection priorities.

The concerns of the Gold panel about potential abuse of monopoly powers given to the ROS appear to be well-founded. Several of the independent petroleum shippers in the Great Lakes would not sign an agreement with the ROS and pay the fees, because the fees had not been approved by the Minister. That is, the shippers would not pay because, in their minds, the fees were not legal. The majors then apparently refused to deal with the ships of the independents because the ships were not covered by an arrangement. One independent retailer of petroleum products in the Great Lakes claims that his business has declined by 50% because the majors place restrictions on his ability to use his own ships to berth at their facilities[9].

[9] private correspondence with two affected independent distributors and retailers, March 98

Conclusions

This initiative was an attempt by the government to change, dramatically, its traditional approach to delivering services. The result could have been an innovative *Public-Private Partnership*, along the lines of *NavCanada*. Unfortunately, the actual result is unworkable.

In the details, sustainable development and environmental protection were made secondary to the guaranteeing of the revenue streams for the major oil companies who had levered themselves into monopoly positions. Localized pollution prevention and environmental protection should have been blended with the creation of the large Response Organizations required to deal with major spills.

Some of the predicted and harmful effects on competitiveness of independent Canadian retailers of petroleum products, especially in the Great Lakes, appear to have been confirmed.

The principles of sustainable development and cost-effective approaches to environmental protection should be important components of the new governance structure that the Minister will be studying soon.

Ministers will continue to be lobbied on this initiative. It has potentially major effects on industrial competitiveness through its effects on domestic oil prices.

5.2 ENVIRONMENTAL ASSESSMENT (EA)

Background

The *Canadian Environmental Assessment Act* establishes a duty of the Canadian

Environmental Assessment Agency (the Agency) to provide administrative support for EA review panels. The EA cost-recovery initiative for these review panels has been under consultation since 1995. The initiative is awaiting final consideration by the Treasury Board. The Treasury Board Submission, Regulation, Order in Council and RIAS have all been submitted to the Board.

This cost-recovery initiative appears to have been exceptionally well-designed. The design includes:

- formal process efficiency measures;
- an MOU on likely costs before a Panel begins its hearings and research so that a project proponent has some idea of the likely costs;
- independent audits of costs; and,
- a formal dispute resolution mechanism[10].

These are all supposed to be components of Federal cost-recovery programs under the Treasury Board policy, but seldom are.

This is one of the few cost-recovery initiatives in which the government agency is changing how it does its business in order to ensure transparency in its recoverable costs. In particular, the Agency is introducing time reporting on its cost-recoverable projects so that actual (not average) costs are charged to projects.

As in most of the cost-recovery initiatives, it was critical to separate costs that benefit the public interest from those that directly benefit project proponents[11]. EA activities that benefit the public will continue to be funded through voted, tax-based appropriations. In addition, costs eligible for cost recovery must be "avoidable",

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[10] *Cost Recovery of Environmental Assessment Panel Reviews,* Appendices to the Treasury Board submission
[11] ibid., Appendix I

i.e. they would not have occurred had the project under assessment not existed. Therefore, only direct and actual costs incurred in conducting the review panel will be recovered, and not full costs. Approximately 65% of the full costs for supporting each review panel will be recovered from project proponents.

Impact Assessment

The impact assessment reports no likely impacts for this program. Experience has shown that projects subject to panel review tend to have large capital costs (averaging $900 million), and are sponsored by well-financed proponents. Furthermore, panel review costs have averaged only 6/100 of 1% of the total capital costs of the project[12].

The program includes special financing arrangements that will be made if a *Business Impact Test* (BIT) shows that the EIA fees are likely to have a serious effect on the financial viability of the proposed project. These arrangements may include extended repayment schedules but will not abandon the principle of cost-recovery.

Conclusions

This cost-recovery program could serve as a model for the design of others. It contains all of the ingredients to show those who now must pay that there is concern with delivering value for money. The goals of sustainable development and competitiveness have all been respected in the design of the cost-recovery program. As well, the changes in business practices by the agency could lead to increases in the efficiency in the use of public resources.

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[12] ibid.

5.3 THE PEST MANAGEMENT REGULATORY AGENCY

Background

This continues to be a particularly contentious cost-recovery initiative.

Health Canada formed the *Pest Management Regulatory Agency* (PMRA) in April 1995, in response to studies that documented unreasonable delays in introducing new pest control products into Canada. At that time, the PMRA was identified as subject to the cost-recovery policy.

The new agency's size and budget became, immediately, a major point of concern. Several industry sectors (*Crop Protection Institute*, *Canadian Manufacturers of Chemical Specialties Association*, the *Horticultural Association*, etc.) banded together to present the industry concerns and to ensure that process efficiency measures were implemented along with the levying of costs. It is interesting to note that these organizations together account for at most 20% of registrants (about 200 out of 1000), but about 50% of product registrations (about 3000 out of 6000). The other registrants tend to be small businesses that are not members of an industry association.

As in most cost-recovery initiatives, the issue of public vs. private benefits of PMRA activities was a contentious point. The discussions were protracted and there are still differences of view on the question.

A *Business Impact Test* (BIT) was undertaken in 1996. The Agency and industry did not agree on the interpretation of the results. The industry associations argued that the cost-recovery program would affect profoundly the marketing of pesticides

and that a large body of registrants had not been covered by the impact study. The industry concern was for the loss of business and for the possibly serious effects on competitiveness of Canadian primary producers.

Both the industry and the PMRA have since undertaken extensive lobbying of Ministers and Members. Eventually, Treasury Board approved the PMRA fee schedule and budget but for one year only, starting in April 1997. Performance improvements were to be introduced and the situation was to be reviewed in April 1998. An independent review of the PMRA has just begun (March 1998).

Industry Concerns

There are three main industry concerns.

- It takes longer and is much more expensive to introduce new pest management substances into Canada, thus disadvantaging Canadian producers against their American competitors and slowing the pace of introduction into Canada of environmentally-more-friendly substances. Cost-recovery has made this situation even worse than before.
- Existing products are being withdrawn from the Canadian market at an accelerated rate because of the high costs imposed by PMRA for re-registration.
- There have been no discernible efficiency improvements within the PMRA.

The *Crop Protection Institute* (CPI) has taken the lead in these discussions. Recently, its members prepared statistics on the rate of withdrawal of existing substances from the Canadian market. These data have been presented to the PMRA just a few weeks ago, and comments are expected soon. Until then, the industry is treating the data as confidential and has not released them. The industry

has advised us, though, that these data indicate a much higher rate of withdrawal than has been reported to date.

A major driver of these effects, according to the industry, is the small size of the Canadian market. Foreign developers of the new chemicals are reluctant to incur the Canadian costs to introduce the new substances because the potential return is seen to be small compared to the costs. Industry representatives believe that the recent data (see above) supplied to the PMRA bears out this case.

The CPI also notes in recent correspondence that performance times for the PMRA remain "*dismal*". There have been no process improvement that the industry can note.

The most recent financial report by the PMRA indicates a revenue shortfall of about $4.1 million. That is, revenues are only about $7.5 million compared to the forecast of just over $12 million.

Industry believes that the large part of this shortfall is in the "maintenance" category, meaning that a significant number of substances are either not being re-registered or at a lower level. If this reduction in re-registrations is not matched by an increase in new registrations, then the net effect will be a reduction in the number and variety of pesticides available to Canadian producers. This can put Canadian producers at a significant competitive disadvantage compared to their American competitors.

An independent review has just been commissioned by Health Canada (March 1998) and is to be completed by the end of April 1998. The terms of reference for this review identify the following aspects of competitiveness and sustainable

development that are to be examined[13]:

- an independent assessment of and analysis of performance, program cost and cost recovery (of the Agency);
- performance standards, program cost and user fees;
- covering all submission types.

It appears that this review will emphasize a comparison of the performance of the PMRA against its equivalents in four other countries.

It is not clear from the terms of reference whether the review team will attempt to determine explicitly if environmentally-more-friendly substances have been withheld from the Canadian market as a result of PMRA and its cost-recovery charges. This has been a major charge levied against both the PMRA and the NSN programs, and it would be useful to shed some light on the issue. Neither is it clear whether the review team will attempt to quantify the competitiveness impacts of any adverse comparisons.

Conclusions

This cost-recovery initiative has been a source of major controversy. Many Ministers have been dragged into the fray. The Canadian industries affected believe that:

- cost-recovery has exacerbated their competitive disadvantage compared to the US, their most important competitors, by increasing their costs and reducing access to new products that make them more competitive;
- environmental protection and sustainable development are adversely affected by the increased difficulty of getting new, environmentally-more-friendly,

[13] Terms of Reference, *Benchmarking Study: PMRA Performance Standards and Costs*, March 1998

products into Canadian commerce; and

- cost-recovery has not been accompanied by significant cost reduction initiatives on the part of the Agency.

Unfortunately, there is little available information that supports or refutes these claims. The independent review to be completed by the end of April 1998 may shed some light on them, but it is being carried out in a short time. Ministers can expect to continue to hear more on this particular cost-recovery initiative.

5.4 TRANS-BOUNDARY MOVEMENT OF HAZARDOUS WASTES

Background

The transboundary movement of hazardous waste is controlled under the provisions of the *Canadian Environmental Protection Act* (CEPA) through the *Export and Import of Hazardous Wastes Regulations* (EIHWR).

Environment Canada identified this program as suitable for cost-recovery. Discussions have been underway for two years now. Total costs to be recovered are about $1.4 millions, to be charged to Canadian importers and exporters as well as to those transiting Canada with hazardous wastes. The costs include the direct and indirect costs of Environment Canada and the affected provinces. Three Canadian companies in Ontario and Quebec will pay about 90% of the charges. One of the three will pay about 50% of the charges. We understand that there are discussions going on within Environment Canada that might lower the total fees, based on some policy changes.

Industry Concerns

The major companies have five concerns:

- special circumstances that make the public vs. private benefits issue more complex;
- the competitiveness impacts, in particular the cost advantage given to American facilities by the charges;
- the charges are believed to be a violation of NAFTA;
- the charges work against recycling which is an important component of sustainable development; and
- the absence of significant cost-reduction initiatives on the part of the Branch.

Special Circumstances Of The Public-Private Issue

The public vs. private benefits issue was, and is, as contentious in this program as in the others. However, there are some special circumstances to this one. The industry representatives point to an Environment Canada publication (circa 1987) that informs the public of a new bilateral agreement between Canada and the US concerning notification of trans-boundary movements of hazardous wastes, a trade that even then exceeded 100,000 tonnes per year. This publication recognizes the environmental and economic benefits of minimizing the distance that hazardous wastes must travel. The documents states that the purpose of the agreement was "*...to lessen any threat to the environment or public safety*"[14]. The benefits to industry predated the bilateral agreement. The bilateral agreement was introduced to provide an added level of protection to the public.

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[14] *Canada-USA Agreement on the Transboundary Movement of Hazardous Waste*, Environment Canada, circa 1987

The industry representatives believe that these special circumstances call for a much lower level of cost-recovery than other regulatory programs.

The Charges Affect Competitiveness

It was difficult for the industries to estimate precisely the effects of the charges on flows because they don't know the next-cheapest alternative available to their clients. That is closely-guarded commercial information. Yet the RIAS reached the conclusion that the fees were unlikely to cause serious immediate disruptions in the trans-boundary flows of hazardous wastes. A BIT (or BIT-equivalent) analysis might have helped here.

After extensive discussion, representatives of the three major companies agreed that that conclusion is probably correct in the short term. The three have worked hard to establish themselves as integrated North American players and depend for 40-50% of their business on the US flows into Canada. Their continuing success depends on being successful in that market place. The companies would not let that business disappear as a result of one charge, as long as the charge was not clearly exorbitant.

However, they point out that this overall conclusion is simplistic in that it masks the other important effects of the charges on their competitiveness. One company noted that the notification/manifest system is the "*largest barrier to competition we face in the United States market.*[15]"

This business is mature and highly competitive, with prices and margins dropping continually. Prices have dropped, on average, by about 10% per year. This is a

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[15] private correspondence with company executives, March 16, 1998

time of transition, with all companies trying to regain profitability by moving to the higher-end wastes. The Environment Industry Digest has reported a "... *significant number of closures among environmental firms from 1994-1996*"[16] in the US, along with major consolidations. The cost-recovery charges add to an already-competitive, difficult environment.

The charges will come from somewhere in the companies' operations. Over 1 million dollars cannot just be taken from three companies with no discernible effects. There are three possibilities:

- the affected customers pay the required 5%-10% increase in costs;
- the companies spread the increased costs over their US and Canadian customers, not just those with trans-boundary movements; and
- the companies cut internal costs to offset the charges.

The market would not bear the first two actions, leaving only the third. Reduced R&D and job reductions or postponements of hirings are the most likely effects. It is particularly galling for the companies to be forced into such action when they see little sign of Environment Canada undertaking significant cost-reduction initiatives.

The companies also point out that the RIAS missed other important effects on competitiveness beyond the immediate disruption of individual flows. For example: all three major Canadian firms in this sector are establishing themselves as integrated North American competitors, building, in many cases, on a Canadian technology or facility. These fees discriminate against them doing so in Canada. The new incentive of the charges is to capture US business through US facilities, not through getting better utilization out of Canadian technical facilities. This is

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[16] *EI Digest*, 1997, No. 5

contrary to the notion of becoming integrated North American players building on a Canadian presence.

The RIAS also omitted to point out that the TBM charges are just one of many fees being levied by Canadian governments on this industry. In Ontario alone, the Ministry of Environment has signaled its intention to levy charges totaling over $7 million per year on this industry. The impact assessments did not consider these Provincial charges on the industry. It is of little comfort to the affected industry to point out that the federal government cannot influence the policies of provincial governments, and vice versa. The industry must pay all of the costs, and it is unrealistic to assess impacts unless all costs are considered.

The Charges May Be Contrary To NAFTA

The cost-recovery charges will apply only to international shipments of hazardous wastes. In particular, there will be no federal fee for similar domestic services. The companies note that this appears to be in violation of the following Articles of the NAFTA.

Article 315: Export Taxes

Except as set out in Annex 315 or Article 604 (Energy - Export Taxes), no Party may adopt or maintain any duty, tax, or other charge on the export of any good to the territory of another Party, unless such duty, tax, or charge is adopted or maintained on:

(a) exports of any such good to the territory of all other Parties; and

(b) any such good when destined for domestic consumption.

Article 316: Other Export Measures

1. Except as set out in Annex 316, a Party may adopt or maintain a restriction otherwise justified under the provisions of Articles XI:2(a) or XX(g), (i) or (j) of the GATT with respect to the export of a good of the Party to the territory of another Party, only if:

(b) the Party does not adopt any measure, such as a license, fee, tax or minimum price requirement, that

> has the effect of raising the price for exports of a good to that other Party above the price charged for such good when consumed domestically, except that a measure taken pursuant to subparagraph (a) that only restricts the volume of exports shall not be considered to have such effect; and...

Article 1202: National Treatment

> 1. Each Party shall accord to service providers of another Party treatment no less favorable than that it accords, in like circumstances, to its own service providers.
>
> 2. The treatment accorded by a Party under paragraph 1 means, with respect to a state or province treatment no less favorable than the most favorable treatment accorded, in like circumstances, by such state or province to service providers of the Party of :: forms a part.

The companies point out that the US Congress attempted, during the period 1991-1994, to implement fees to cover the USEPA's costs of managing the transboundary system that was then in place. Conflict with the *Free Trade Agreement* (FTA) was one of the reasons why the fees were abandoned. We understand that the Canadian Embassy then supported the position that the fees would be in violation of the FTA. Of course, much of the language of the FTA was copied into the NAFTA.

The Charges Work Against Sustainable Development

Some of the companies believe that the charges will have a disproportionate effect on recyclables. Recyclables typically have smaller profit margins than the other hazardous waste streams. The charges will send some recyclables to waste disposal or to American competitors who do not have to pay the same fees. On this point, the companies disagree with the conclusion of the RIAS.

Discouraging recycling goes contrary to the government's sustainable development principles, and common sense. Recycling faces enough economic barriers already without adding to them. The fees should not discourage recycling.

However, it would not be equitable to merely reduce the charges on recyclables and increase the charges on the other remaining hazardous waste movements. That would be a clear example of cross-subsidization, with the remaining hazardous wastes paying for the public policy goal of not discouraging recycling.

We understand that the Department is re-considering the recyclables issue, and may amend the proposed fees.

The Cost-Reduction Initiatives Are Not Significant

This has been a contentious issue in all of the cost-recovery initiatives; TBM is no exception. The industry is particularly aggravated by the decision of the TBM Division to hire two additional staff to implement cost-recovery. The Division's response is that its workload increased significantly, and the additional staff were required to meet the demand. The TBM Division points out, rightly, that the Treasury Board policy on cost-recovery acknowledges the possible requirement for extra staff and equipment to implement cost-recovery. However, the policy also states that cost reduction and rationalization are to be integral parts of cost-recovery. The Division believes that the affected companies could reduce their internal costs of complying with the regulations, and has undertaken to work with the companies to identify savings and simplifications.

The cost-reduction initiatives reported in the latest discussion document[17] and the in-house government efficiency studies are, to the industry, vague and unlikely to reduce costs. This approach feeds the impression by those affected that cost-recovery is merely an excuse to generate revenue, a way to restore the budget cuts imposed by the Cabinet and to avoid the painful adjustments caused by reduced

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[17] *Cost Recovery For The Export and Import of Hazardous Wastes Regulations*, Summary of Stakeholder Consultations Held in July 1997, September 8, 1997, page 6, Costs

budgets. It is the affected companies that will now have to make all of the painful adjustments.

To those affected by the new charges, the same old work is being done in the same old way. The only difference now is that some companies are paying part of the much-disputed costs.

Conclusions

The affected companies believe that this program has a history demonstrating that it provides largely public as opposed to private benefits. They also believe that the cost-recovery initiative is contrary to NAFTA and works against their goals of becoming Canadian-based North American players in this competitive industry. They also believe that recycling will be discriminated against. The solution to this latter point is not to reduce the charges on recyclables and raise the charges on the remaining wastes.

The lack of significant cost-reduction approaches means that there will be no increase in the efficiency with which the public sector is using scarce resources. Only the private sector is making adjustments to the new costs of doing business.

5.5 OCEAN DISPOSAL

Background

Environment Canada regulates the disposal at sea of substances and meets its international obligations under the *London Convention 1972* by means of permits issued under Part VI of the *Canadian Environmental Protection Act*. Clients of this program were advised in 1994/95 of the intent to pursue cost-recovery, as part of

consultations on regulatory reform in the program. This was followed by an impact survey in 1995, continuing consultations in 1996 and 1997, and the publication of the associated Regulatory Impact Analysis Statement (RIAS) in late 1997.

The Branch expects to submit the appropriate documentation in support of cost-recovery to the Treasury Board and Ministers before the end of April 1998. . The current goal is to recover $600-800k annually from the charges.

Impact Assessment

The Regulatory Impact Assessment Statement (RIAS) concluded that the private sector proponents "*...are not expected to experience any significant competitive impacts as a result of this incremental increase in their costs*"[18]. This is surprising, given that the immediately preceding statement in the RIAS is that average increases in client project costs as a result of the fee proposal are estimated to be roughly 5%, depending on which fee option is selected[19]. Five percent of total project costs is usually a significant incremental cost.

It is possible that the conclusion is generally correct, given that such a small amount of money is to be collected from what appears to be a large number of clients and that the Federal government itself will pay a large share of the costs. But there are important caveats to note about the RIAS.

- Some major interests on the West Coast declined to participate in the impact study, apparently because of strong opposition to the fees and in particular to national fees. The impact consultants took this refusal to participate as a

[18] *Impacts of Cost Recovery of Ocean Disposal Monitoring*, Environment Canada, October 28, 1997, Executive Summary, emphasis in original document
[19] ibid., same page

sign of "*no impact*"[20], rather than recording it correctly as "*no information*". On the West Coast, little is known about the competitiveness impacts of the fees.

- The RIAS understates significantly the level of the other *Marine Service Fees* that may affect some of the clients of the Ocean Disposal program. The amount of $26.7 million quoted is a one-year moratorium total only. The fees could rise to over $60 million. This affects the impacts.
- The statement that impact thresholds of 0.75% and 1.5% as a percentage of cargo value were "*...recently developed in consultation with the marine community*[21]*" is not correct. The marine shippers did not agree in the previous Coast Guard impact work that 0.75% and 1.5% of cargo value were meaningful indicators of likely impact. In fact, in one case, these levels amounted to a 30% tax on the bottom-line profits. The Coast Guard used these thresholds, but they were never accepted by the businesses. This understatement of impacts was one of the reasons the marine shippers succeeded in having a moratorium imposed on the fees.*
- *The RIAS argues that ocean disposal fees could not be significant because they are a small proportion of all of the other fees being levied. This is a circular argument that undercuts the purpose of cumulative impact assessments. Even if each fee is small, it is the cumulative total that is supposed to be assessed.*

Cost Reduction and Rationalization

Several of the clients of the program suggested that they could operate a monitoring program more cheaply and effectively than the government could[22].

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[20] ibid., page 2 and throughout the report
[21] ibid., page 8
[22] *1997 Report On Consultations On Cost Recover For Monitoring At Ocean Disposal Sites*, Environment Canada, Marine Environment Division, 1997, page 12, *We Could Do It Cheaper*

They also questioned the high overhead rates used to calculate the costs.

The Department responded that "... it is the Minister's responsibility to monitor[23]". The Department's view was that it had the accumulated experience to do the job, and should continue to do so for another five years. After that period, alternative arrangements could be considered. The rates were justified by government accounting practices.

While probably well-intentioned, this response by the government's agencies is disturbing to those who must pay the new fees. The agencies appear to make no serious attempts to reduce costs or consider innovative service delivery arrangements. The industries and other clients see themselves as the only ones making the painful adjustments that are required to pay the new costs of doing business. The response of "business as usual but now pay for it" is not in accordance with the cost-recovery policy of making re-engineering an integral part of introducing user charges. There will be no increase in the efficiency in using public resources, which was the underlying rationale of the cost-recovery policy.

Conclusions

This cost-recovery initiative represents a large investment on the part of the government agencies in consultation, impact assessments etc. All for the recovery of about $800k per year, much of that coming from the Federal government itself.

The absence of cost reduction and re-engineering alternatives, including privatization, is a weakness to this initiative. There will be no increases in the efficiency in the use of scarce government resources.

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[23] *1997 Report on Consultations on Cost-Recovery For Monitoring At Ocean Disposal Sites*, Environment Canada, 1997

5.6 THE NEW SUBSTANCES NOTIFICATION PROGRAM

Background

The *New Substances Notification Regulations for Chemicals and Polymers* (NSN) came into effect on July 1, 1994, under the authority of the *Canadian Environmental Protection Act* (CEPA). These regulations are intended to ensure that no new substance is introduced into the Canadian marketplace before an assessment is made of its toxicity. Environment Canada and Health Canada share responsibility for the assessment of new substances: Environment Canada for potential environmental risks, and Health Canada for potential human health risks. The regulations are administered by the New Substances Division of Environment Canada. That Division has taken the lead in the cost-recovery consultations.

The NSN regulatory program is currently undergoing a three-year review as a prelude to the consideration of changes to CEPA, expected to be introduced in the Spring of 1998. The affected industries, under the leadership of the *Canadian Chemical Producers' Association* (CCPA), are participating in the review which will be completed in May 1998.

The cost-recovery consultations on this program have been going on for about two years. The chemical industries are strongly opposed to cost-recovery for NSN. The industries believe that the extra costs will make even worse the competitive disadvantage that they labor under as a result of the NSN regulations themselves. As we will see, the resistance to cost-recovery for NSN is tied up with concerns about the harmful competitiveness effects of NSN itself. The annual revenue goals for cost-recovery are currently at about $800k, about 25% of actual costs, but started out much higher.

Chemical innovation is a major driver of industrial cost-competitiveness and product innovation. The Canadian chemical industry has been concerned, since the inception of the NSN program, that Canadian regulations make it more difficult and expensive to introduce new chemical substances into Canadian manufacturing and R&D. In particular, it is faster, easier and cheaper to get new substances into the market in the US than it is in Canada. This, the industry argues, makes Canadian manufacturing less competitive against their most important competitors. the US. The industry wants an increased harmonization of US and Canadian substance regulations.

Of course, making it more difficult to introduce new substances into Canada is precisely what the architects of CEPA and the NSN regulations had in mind. CEPA and the NSN deliberately set out an approach for Canada that is different from that adopted in the US. The industry concern, as we will see below, is that the effects have been disproportionate to the benefits, that sustainable development has suffered and that cost-recovery will make the situation even worse.

The cost-recovery initiative, after several years of intensive negotiations and near-stalemates, has yielded a cost-recovery proposal that is now in the impact assessment stage. A *Business Impact Test* (BIT) is being designed by Environment Canada and industry representatives. It will be completed in May-June 1998. The negotiations have been long, at-times difficult and have dragged several Ministers into the issues.

There are two important parallel fronts for this cost-recovery initiative.

- Discussions continue between Environment Canada and the US EPA on possible approaches to increasing the harmonization between the two regulatory agencies. From industry's perspective, the ideal solution would

be *Mutual Recognition Agreements* (MRAs), under which a substance admitted into one market would receive a special fast-track approval processing into the other.

- Service standards under cost-recovery are being developed in consultation with the industry, along with preliminary approaches to cost-reduction. The Branch did consider, briefly, alternative delivery arrangements, but the commercial significance of its decisions stands in the way of increased privatization.

Industry Concerns

The Canadian chemical industry identifies the following major effects of the NSN regulations and cost-recovery.

- New substances take longer to get into the Canadian market than in the markets of competitors because of the more stringent regulations here.
- The substances will be more expensive once they do get in because of the costs and delays.
- Some new substances will not be introduced because the delays and costs make the small Canadian market unprofitable for the substance developers.
- Canadian manufacturing industries suffer too because their (mainly US) competitors benefit from chemical innovation or as manufacturing moves south to access the new substances.
- The NSN regulations work against the thrust of NAFTA by imposing differences between the Canadian and US markets instead of increasing harmonization.
- Cost-recovery will make this serious situation even worse.

The third point, about products not being introduced into Canada, requires explanation. Most new chemical substances are not developed in Canada.

Typically, they are developed elsewhere and introduced first into larger international markets such as the US, Europe, and Asia. The Canadian market for most chemicals is small by international standards. Thus, if the incremental costs are high to introduce a new substance into Canada, the substance developers might bypass the Canadian market since the returns cannot justify the higher costs. This effect would work even more harshly against domestic Canadian chemical developers who have to pay the higher notification costs right at the beginning. International chemical companies could develop the substances elsewhere, postponing until later a decision about the Canadian market.

The industry's concern with NSN cost-recovery is that the additional costs will make this situation even worse. The Canadian chemical industry and its clients, which include much of Canadian manufacturing, will be put at an even more serious competitive disadvantage. The costs of new substances will rise even higher and even more substances will be withheld from the Canadian market.

A related industry point is that these effects are preventing new, more environmentally-friendly substances, from replacing old substances that are more damaging to health and the environment. If so, sustainable development is being hampered by the regulations.

The Evidence To Date

A major challenge to the three-year review is to determine if there is evidence to support these concerns.

There are two current sources of information on the impacts of the NSN regulations: the September 1997 draft of the "*Report of the NSN Impact Working Group*", being prepared as part of the three-year review; and, a set of 10 case

studies prepared in late 1997 by industry representatives. Most of the 10 case studies are also presented in the draft report.

The draft impact report presents the views of industry on the above effects. We summarize below the main findings.

Reduction In The Number Of Substances Introduced Or Commercialized

Approximately 20 cases are described of substances not considered for commercialization because of the NSN costs, or new substances not introduced into Canada because of notification costs[24]. In several of the cases, it seems clear that the NSN compliance costs were an important part of the decision to not introduce the substances into Canada.

Effects On The User Industries Of Restricted Access To Imported Substances

The effects were reported to be "*substantial but difficult to quantify.*"[25] Companies provided a number of specific examples in which they believed that the NSN compliance costs had resulted in Canadian manufacturers being denied a substance available to US and other foreign competitors[26]. Here are three of the approximately 15 examples presented.

- "*We have caused some business disruptions to approximately 80 customers by discontinuing 40 substances*"
- "*Canadian branches of US companies are losing production to US branches due to notification costs.*"

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[24] *Report of the Impact Working Group*, September 1997 draft, chapter 4, sections 4.2.4 and 4.2.5
[25] *ibid., chapter 4, summary, page 12 (f)*
[26] *ibid., section 4.2.6*

- *"We have the opportunity to supply a US market for a specialty coating; however, unlike the competing US supplier, we face a costly and time-consuming notification."*

There was concern that the competitiveness of Canadian industry was being eroded by this reduction in the availability of substances.

Competitiveness is usually a result of the interaction of many factors. In practice, it is difficult to single out the effects of the absence of one of the many components of competitiveness(in this case, new chemical substances). The companies encountered this difficulty in trying to estimate the effects on their clients of the non-availability of specific substances.

Environmental Benefits Foregone

Examples are provided of substances which, in the opinions of the notifiers, would benefit the environment but which were not being introduced into Canada because of the NSN notification costs.[27] However, no justification is provided for the assumed environmental benefits, beyond the replacement of known harmful substances by other substances. In some cases, it appears that the need for commercial secrecy might have made it difficult to provide details.

Conclusions

The strong opposition to this cost-recovery initiative stems, in large part, from strong industry opposition to the effects of the current NSN regulatory program. Industry believes that the NSN program puts them and the rest of Canadian industry at serious competitive disadvantages to their (mainly US) competitors. Cost-recovery applied to NSN will make the situation even worse, in their view.

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[27] *ibid., section 4.2.7*

The three-year review of the NSN will be finished soon. It will be part of the Parliamentary debate about a new CEPA, during which the impacts of NSN will be examined closely and new policy directions set. It might be appropriate to postpone cost-recovery for NSN until these deliberations have taken place and new directions established.

6. CONCLUSIONS AND RECOMMENDATIONS

Our review of the case studies leads to the following conclusions and recommendations.

- Implementation of cost-recovery has been contentious. Ministers are getting dragged into the details of their own initiatives, and those of other Ministers.

- Implementation will continue to be controversial. Ministers will be lobbied extensively on cost-recovery initiatives.. The amount of money being recovered, for many of the programs, is very small.

- The issue of public vs. private benefits for regulatory programs will continue to be difficult. The Treasury Board policy provides no practical guidance on the issue. The government should provide guidance to agencies before further cost-recovery initiatives are implemented, to reduce the pressure being put on individual Ministers.

- These cost-recovery and user-charge programs are believed to affect industrial competitiveness in two ways:

- directly, by imposing fees and charges that are not paid by major international (particularly the US) and domestic competitors. The ROS and TBM programs are examples of this effect; and,

- indirectly, by aggravating an already-disadvantaged situation caused by more costly Canadian regulations than those in competitors' countries. This applies particularly to the PMRA and NSN programs.

- Industry believes that a further effect of the more-costly regulatory approach in the cases of PMRA and NSN is to keep new, environmentally-better substances out of the Canadian market. If so, sustainable development is being compromised. Cost-recovery will accentuate the problem

- In some cases, there is evidence to support the above points. In others, it has proven to be difficult to extricate the incremental effect of the more-costly Canadian regulations on competitiveness. This is a common difficulty.

- The cost-recovery goal has prevailed over that of sustainable development, in part, in two of the programs. The new governance system to be developed for marine oil spill responses should balance the goals of sustainable development, industrial competitiveness and financial viability. The *Trans-Boundary Movement* program should not discriminate unduly against recyclables.

- Of the five cost-recovery programs examined that remain within government, only one (Environmental Assessment) contained significant re-engineering and cost-reduction approaches. The other four did not. Without such changes, there will be no increase in the efficient use of scarce public resources, as called for in the government's cost-recovery policy. It is only the affected industries who are making the difficult adjustments to the new costs of doing business.

- The cost-recovery agencies are similar to unregulated monopolies: they face no commercial pressures to reduce costs or increase services, no competition is allowed and there are no limits to future fee increases or to arbitrary changes in

service levels.

- The Environmental Assessment cost-recovery initiative should serve as a model for others. It contains all of the elements required in the cost-recovery policy.

- Three of the cost-recovery initiatives (TBM, OD, NSN) represent large expenditures of public and private resources on consultation, studies etc. extending over several years. The total amount of money to be recovered by all three programs is less than $3 million annually.

- The introduction of proposed changes to the *Canadian Environmental Protection Act* presents an opportunity to air thoroughly the issues of the effects on Canadian industrial competitiveness of regulatory approaches such as NSN and PMRA. It might be appropriate to postpone further environmental cost-recovery until those discussions have taken place and new environmental policy directions are set.

ANNEX

PEST MANAGEMENT REGULATORY AGENCY'S COMMENTS

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September 4, 1998

Mr. Ron Harper
Director
Environmental Affairs Branch
Industry Canada
235 Queen Street
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Dear Mr. Harper:

This letter is in response to your letter dated June 30, 1998 in which you asked the Pest Management Regulatory Agency to review and comment on the March 31, 1998 report prepared by Cowan Research Inc., entitled:

The Implications to Competitiveness and Sustainable Development of Environmental Cost Recovery Initiatives of the Canadian Federal

Government.

The purpose of the Cowan study has merit. It would be helpful to have had substantiated information on where cost recovery does negatively affect competitiveness and sustainability so that changes could be made. The study does not point to specific problem areas nor provide any suggestions on how to improve the situation.

It is unfortunate that the consultant did not interview PMRA staff responsible for cost recovery, performance and sustainability initiatives. It would have been useful for the consultant to have a better understanding of the creation of the PMRA, its mandate, its plans, its current activities in the sustainability and efficiencies areas, and the various activities related to cost recovery.

The goal of the PMRA is to protect human health and the environment while supporting the competitiveness of agriculture, forestry, other resource sectors and manufacturing. The PMRA is responsible for providing access to pest management tools, while minimizing risks to human and environmental health. The Agency is also dedicated to integrating the principles of sustainability into Canada's pest management regulatory regime. A lot of progress has been made since the creation of the Agency in 1995 and the introduction of the new cost recovery fees in April 1997. There are many initiatives under way that support the Agency's goals on sustainability and competitiveness.

The PMRA would like to provide information and clarification on a number of subjects that were mentioned in the Cowan report's review of PMRA's cost recovery initiative.

Creation of the PMRA

The PMRA was formed by the Government of Canada in April 1995, in

response to the multi-stakeholder Pesticide Registration Review (PRR). The PRR examined the entire pest management regulatory system and recommended broad changes ranging from public participation in the decision-making process to cost recovery and improved time lines for review. The PRR report, "Recommendations for a Revised Federal Pest Management Regulatory System" (December, 1990) addressed concerns of stakeholders regarding competitiveness, sustainability, public health, environmental protection and public consultation. The report recommended consolidation of pest management regulatory responsibilities and resources from four different departments (Agriculture and Agri-Foods Canada, Health Canada, Environment Canada and Natural Resources Canada) into a single Agency in Health Canada.

In October 1994, the government issued the *Government Proposal for the Pest Management Regulatory System* outlining detailed plans for reforming the regulatory system. The goals and activities of the PMRA are based on this document, which addressed the varied concerns of stakeholders by proposing program and policy changes adapted from the PRR recommendations. Key elements of the plans included:

- establishment of the PMRA;
- establishment of an Alternatives Office within the agency, with roles in policy and decision-making and strong linkages with sectoral departments;
- introduction of new legislation to provide the foundations for the reformed system;
- improved opportunities for public access to information and public participation in regulatory decision making;
- implementation of performance standards, acceptable to stakeholders, for the review of registration applications;
- implementation of a cost-recovery regime, in consultation with stakeholders;

- development and implementation of streamlined registration procedures for minor uses and alternatives to traditional chemical products; and
- acceleration of registration, re-evaluation and special review processes through harmonization and work sharing with other regulatory agencies

In February 1995, the government decided to create the PMRA and carry out the reforms laid out in the Government Proposal.

It is important to recognize that the government-wide move to cost recovery coincided with the decision to establish the new Agency. In its response to the PRR report, the government recognized that there would be a need to increase resources of the Agency in order to implement the recommendations made by stakeholders. Part of these resources was to come from cost recovery.

Sustainable Development

Pest control products differ from many other substances that enter the environment in that they are not by-products of a process, but are released intentionally for a specific purpose. Although their biological effects are what make most pest control products valuable to society, these effects can also pose risks to human and environmental health. For this reason, the Pest Control Products Act and policies affecting pesticides recognize and consider both human health and environmental risks. The value of each product is also considered in the regulatory process. Thus, the integration of social (including health), environmental and economic considerations is fundamental to the business of the PMRA.

The Agency has created an Alternative Strategies and Regulatory Affairs

Division that promotes the development, consideration and adoption of sustainable pest management practices both within PMRA and among users of pest control products. PMRA is working to facilitate access to reduced-risk chemical and biopesticide products and to coordinate the development of long-term sustainable pest management strategies in a wide variety of user sectors. PMRA is also developing a re-evaluation program in cooperation with the US and other OECD countries to ensure that older pest control products meet current safety standards PMRA initiatives in support of sustainable pest management are part of the Action Plan containing Health Canada's commitments in the Sustainable Development Strategy tabled in Parliament in December 1997.

Competitiveness

The PMRA's cost recovery policy, published in December 1995, proposed that the fee schedule would be designed to avoid deterring registration of pest control products, particularly products for minor uses and alternatives to traditional chemical products.

In 1996, the PMRA, cosponsored with the Crop Protection Institute (CPI), the Canadian Manufacturers of Chemical Specialties (CMCS) and Industry Canada, a very extensive Business Impact Test (BIT), which was carried out by an independent consultant (Brogan Consulting Inc.). The BIT was conducted on three preliminary fee structure options initially proposed by the PMRA in *Discussion Paper: Cost Recovery Analysis*, April 4, 1996. Pesticide companies representing the range of pesticide use areas from agricultural products to disinfectants to wood preservatives participated in the BIT. The group of companies also represented the range from companies with only a few registered products to those with approximately one hundred registered products.

The PMRA engaged another independent consultant to study the impact of the three proposed fee structures on the biopesticides sector. As a result of this assessment the Agency decided to exempt biopesticides from most of the application fees.

In addition, impact assessments were carried out for pesticide user groups: the agricultural sector, forestry, and users of other use patterns, including pesticides for pets, swimming pools and golf courses.

Results of these impact assessments were presented at a public stakeholder meeting, which was followed by a consensus-building meeting with stakeholders to develop a proposed fee structure. The revised fee schedule and industry comments were published in Canada Gazette I and II. The cost recovery regulations came into force April 16, 1997.

Evidence to date on the impacts of cost recovery has shown that where agricultural product registrations were withdrawn by registrants in 1997 there were other products still registered for the same uses, so that producers were able to deal with the same range of pests as before the introduction of cost recovery. Surveys on pesticide prices have not shown any abnormal price increases. There has been no increase in the use of the own use import program by agricultural producers, which would indicate that significant price differentials have not developed between Canada and the US.

The PMRA is committed to assessing the impact of the regulations it administers on the competitiveness of pesticide companies and Canadian users of pesticides. The Agency has participated in a cumulative impact study conducted by Agriculture and Agri-Food Canada to assess any impact that government fees may have on the agriculture and agri-food sector. Health Canada has also commissioned an independent bench

marking study to compare the performance, cost and cost recovery of the PMRA with pesticide regulatory systems in the US, UK and Australia. PMRA will address any competitiveness issues raised by these reports once they are released.

Cost Reduction

In 1995 when the PMRA was created, government approved a budget of $34 million with a cost recovery target of $22 million. Cost reduction measures and program modifications, combined with contributions from AAFC, allowed PMRA to reduce its cost recovery target by $10 million to $12 million in an overall budget of $27 million.

Revenue Shortfall

The PMRA has approximately a $4 million shortfall in the revenues generated by maintenance fees. The expected revenue from maintenance fees was estimated on the basis of information provided by registrants through the Business Impact Test. The BIT overestimated the number of products that companies would withdraw but underestimated the number of products eligible for reduced fees. The maximum maintenance fee is being paid on fewer products than forecasted. This suggests that the sample of registrants selected for the BIT was not representative of the total population of registrants. This is not entirely surprising because industry wide sales on a product basis were not available to the BIT consultant, PMRA, CPI, CMCS and Industry Canada when they were selecting the BIT participants
(these figures are still not available). The revenue shortfall has resulted in the delayed implementation of new programs, such as re-evaluation of registered products, and a six month delay in elimination of the backlog of submissions.

Efficiency Gains and PMRA Performance

The PMRA is committed to improving processes and to reducing costs and length of time associated with the review of new submissions. The Agency's target is to reduce review costs for complex submissions by 40% over six years. This target will be achieved through internal efficiencies and harmonization activities.

The new internal processes that the Agency has introduced to date have already contributed to its capacity to implement the planned reforms. A streamlined process for screening and management of the review of submissions has been an essential component of the successful implementation of an 18-month performance standard for the review of new active ingredients and major new uses (Category A submissions).

The backlog of submissions, inherited by the Agency in 1995, will be eliminated this year. As a result of a joint industry-PMRA working group on the label review process, a pilot project on streamlining the label review process is being implemented.

In the spring of 1997, the PMRA initiated its Electronic Submission and Review Capability Project which will introduce computerized systems to support data exchange and review. Process improvements, based on staff and industry input, are currently being established within the PMRA. Piloting of work flow, electronic document management tools and electronic submissions will take place in 1998. Implementation is planned for winter 1998-99, with savings expected to begin to accrue in 1999.

To provide a central focus for ongoing discussions with its economic stakeholders on efficiency measures, the Agency created the Economic Management Advisory Committee (EMAC). This committee provides

strategic advice to the Executive Director of the PMRA on ways to improve efficiency and cost effectiveness without compromising the mandate of the agency. EMAC is made up of three Agency staff and six to nine industry members, and is co-chaired by a senior member from industry and a senior member from PMRA staff. Industry members are drawn from user groups, pesticide companies and industry associations. The committee is in the process

of developing a work plan with performance targets and action items that reflect joint priorities and the cooperative effort required to meet targets. Several working groups have been established to address common interests.

Pesticide regulators in the Organization for Economic Cooperation and Development (OECD) countries recognize that they could make better use of their limited resources by working together. The PMRA is working with its counterparts in other countries in North America and abroad to harmonize the processes used to regulate pest control products.

PMRA has been actively involved in pursuing harmonization through the NAFTA Technical Working Group on Pesticides (TWG), which facilitates cost-effective pesticide regulation and trade among Canada, the United States and Mexico while recognizing the broader NAFTA objectives of environmental protection and sustainable development.

The goals of the NAFTA TWG are to:

- share the work of pesticide regulation;
- harmonize scientific and policy considerations for pesticide regulation; and
- reduce trade barriers.

Impediments to international trade are being eliminated by regulators

working to resolve differences in acceptable residue levels for treated commodities. Harmonized data requirements and submission formats and joint review processes are making it practical for manufacturers to apply simultaneously for registration in the US and Canada. Canadian requirements for the registration of pheromones are now harmonized with those of the US. Data requirements have also been harmonized for major agricultural and forestry uses of chemical pesticides. The PMRA and the United States Environmental Protection Agency (EPA) announced joint review procedures in 1996 for reduced risk chemicals and in 1997 for biopesticide products; work sharing of pesticide evaluations is being carried out on a regular basis. In April 1998, Canada and the United States completed the first joint review of a reduced risk product. The submission was completed within the performance standard of 61 weeks. Joint reviews increase the efficiency of the registration process, provide more equal access to pest management tools and facilitate the registration of alternative pest control tools by shortening the response time and providing an early-introduction incentive for these "safer" products.

The PMRA is actively participating in the pesticide program of the Organization for Economic Cooperation and Development (OECD) which is working towards global harmonization of test protocols, data requirements and submission formats. PMRA has adopted common OECD formats for presentation of industry data submissions and for the preparation of country data reviews to facilitate common submission formats, the exchange of reviews and work sharing among OECD member countries. Electronic Submission and Review Capability activities are also international in scope, with linkages established between the PMRA and the US EPA, the European Union (EU) and the OECD.

Harmonization supports both competitiveness and sustainability by facilitating introduction of safe and effective pesticides to the user at the

same time as their competitors and reducing costs incurred by regulators and registrants.

Thank you for giving the PMRA the opportunity to review and comment on this report. PMRA is working with all stakeholders to build the strong partnerships needed to enable us to support sustainable development and address outstanding issues related to competitiveness.

Yours truly,

O/S

Wendy Sexsmith
Director

ENVIRONMENT CANADA'S COMMENTS

March 31, 1998 Draft Report by Cowan Research Inc., entitled:

"The Implications to Competitiveness and Sustainable Development of Environmental Cost-Recovery Initiatives of the Canadian Federal Government"

The March 31 draft of the Cowan Research Inc. report has been reviewed in some detail by individuals involved in the three cost-recovery initiatives from the regulatory programs of the Environmental Protection Service. Each of these initiatives was used as a case study in the report. The report has also been reviewed in detail by officers in Corporate Services who are very familiar with cost recovery but who are not attached to the regulatory programs studied in the report.

The comments all carry much the same reaction -- that the Cowan Research Inc. report reflects what appears to be a heavy industry bias and an absence of empirical data, analysis and substantiated conclusions. It is our view that the author(s) should draw conclusions from a more comprehensive analysis of all aspects of the issue.

GENERAL COMMENTS

1. The paper contains conclusions and criticisms for which no analytic base is provided. Even the positive judgements, e.g. for CEAA the "goals of sustainable development and competitiveness have all been respected", are not substantiated.

   The stated purpose of the paper is to review cost recovery in relation to competitiveness and sustainable development. We believe that the

report falls short of meeting the stated objectives. Instead, the author chose to focus on the negative impact of regulation generally with the follow-on that since the impacts of regulation are bad, the impacts of regulation with cost recovery must be worse. This conclusion appears to be based on anecdotal evidence as there is little attempt to quantify, and thereby validate these assertions, including those specific to cost recovery.

2. There are continuing references to the need for greater efficiencies by government. Does this mean that the impact of cost recovery would be acceptable if costs were reduced a bit or, indeed, that any level of charging would be O.K. if the underlying process demonstrated maximum efficiency? As no impacts are described which link efficiency with competitiveness and/or sustainability, it is difficult to identify the problem, if any, or the proposals for solution.

   It is also important to note, that many of the programs are, in fact, involved in restructuring to improve efficiencies and to reduce the regulatory burden on industry. As an example, the New Substances Notification program will establish a joint panel of industry and government officials to oversee the implementation of program improvements.

3. While the document does report a variety of industry comments on our cost recovery initiatives, it is unclear that it includes a significant analysis of the potential impact on competitiveness and sustainable development beyond the simple reporting of industry comments.

   The discussion makes generalized (and sometimes sweeping) comments about the potential impacts. Although for many initiatives, both the clients and the consultant have acknowledged that the fees are generally very

small in relation to the other costs/revenues/profits for the industry; this is not reflected at all in the document. At the same time, the results of our impact studies and industry acknowledgment (to us and to the consultant) that the fees will not significantly alter the way they do business are largely absent or discounted without justification.

In addition, it does not appear that the consultant included the full range of information provided by the program officers involved in these initiatives. In particular, the results of impact studies and information on initiatives to streamline the costs of the programs in question. These documents respond, in whole or in part, to many of the comments of the industry.

We recognize the fact that some of our clients do espouse the opinions reflected by the comments, claims and observations in the Cowan Research Inc. report. Environment Canada is working with these clients to ensure the fullest possible understanding of the department's approach and to promote client involvement in cost recovery decisions.

4. We accept the report's observation that the discussions about the split between public and private benefits have been long and rancorous. Nevertheless, we have carefully delineated the elements of the program that provide a private benefit (i.e. consent to notices for export and import of hazardous waste) and those which are for the public good (enforcement, customs examination, policy development, etc.). In addition, this approach will be further scrutinized through the regulatory process.

5. Many of the observations and conclusions in the report appear to have been provided through discussions with the private sector. It would be extremely useful if a list of those groups and individuals consulted by the author were provided. This would allow a more informed assessment of the breadth and range of concerned industry stakeholders.

Better yet would be the identification of what individual representatives had to say. The Treasury Board Cost Recovery Policy emphasizes the need for meaningful and open dialogue with stakeholders. Clearly the more explicitly the concerns of groups and sectors are understood, the more effectively they can be addressed. Such attribution would position Environment Canada and other involved departments to better understand these issues from a private sector perspective.

In summary, we agree that the author has attempted to represent the views of industry and to provide considered recommendations as to next steps. However, the stated objective of the study was to produce "an analysis of the possible competitiveness impacts of the cost-recovery initiatives". This has not been done. The absence of this analytic base leaves us without validation that the problems exist and without a quantification of the impact on which the need for remedial action could be assessed.

In order to ensure that it is both accurate and useful, we believe that the report needs more work in the areas of:

- presenting a balanced view (including EC responses to issues);
- providing quantitative analysis of competitive impacts to meet the terms of reference under this contract;

- providing definitions and references for critical working terms - (e.g. significant impact or efficiency, sustainable development etc..); and
- better source information (references, participants, specific views).

April 23, 1998

DEPARTMENT OF FISHERIES AND OCEANS' COMMENTS

Mr. Ron Harper
Director
Environment Affairs Branch
Industry Canada
235 Queen Street
7th Floor East
Ottawa, Ontario
K1A 0H5

Dear Mr. Harper:

Thank you for requesting the comments of the Canadian Coast Guard on the study conducted for Industry Canada by Cowan Research, entitled, "The implications to competitiveness and sustainable development of environmental cost-recovery initiatives of the Canadian Federal Government."

I have reviewed the section devoted to the Oil Spill Preparedness and Response regime (section 5.1, "The Marine Spill Response Organizations" in the report), and I regret to say that it is highly inaccurate and misleading in its account of the history of the regime, its basic purpose, and its environmental and economic effects. I am surprised that Industry Canada would commission or accept such a study without consulting this department.

I must question, at the outset, the inclusion of this regime in a study on governmental cost-recovery initiatives. This regime is not a cost-recovery initiative. It is the result of an agreement by industry to undertake significant private sector investments in oil spill preparedness, in response to a series of

recommendations by the Public Review Panel on Tanker Safety and Marine Spills Response Capability. As such, it is wholly consistent with the concept of sustainable development, since it embodies the fundamental principle that the industries that impose a risk on the marine environment should pay their full share of the costs of protecting it.

The fees charged and paid by industry to industry under this regime are in no way directed toward reimbursing government for ongoing or past program expenditures. The regime was not established to replace any government program or service. Rather, it establishes a new and higher level of environmental preparedness, managed and financed by industry, for industry, which is additional to the national preparedness capacity of the Canadian Coast Guard. This is hardly cost-recovery!

The consultant's account of the origin and nature of the regime is highly subjective and inaccurate. CCG did not, as he alleges, "withdraw from the control of the design of a marine oil spill response capability and associated charges." Rather, it was actively involved in the whole process, in a partnership initiative. Neither did CCG give "regulatory powers" to response organizations. The Minister is the undisputed regulator in this regime: it is the Minister who establishes regulations and standards, appoints pollution prevention officers with wide powers to ensure compliance, and who approves or amends fees. In the event of an actual spill, the power of the Minister is considerable. The polluter is responsible for response costs, and is also responsible for taking effective measures to respond. However, CCG monitors every spill response, and has the authority to intervene at any time to direct response in order to protect the marine environment. CCG does not hesitate to use this authority.

The consultant's suggestion that large oil companies set up response organizations to profit from monopoly powers rather than to protect the environment is irresponsible. In fact, substantial investments were required to

create the regime, and only the large oil companies were able or willing to make those investments; yet all potential polluters are obliged to share those costs. The investors in the regime account for approximately 85% of volume shipped and pay the same fees as the non-investors. That is why they expect a return on their capital. There are certain monopoly issues as a result of the ownership of response organizations by large oil companies, such as the appropriate return on this equity, and these issues are being addressed. However it is misleading to characterize the large oil companies in the way the consultant does

The consultant's account of the fee-proposal and objection process is similarly loose and somewhat confused. For example, he says that "contracts" were Gazetted by ROs, and seems to suggest that the contracts were the subject of objections. This is untrue. Fees proposed by the ROs (never contracts, which are a matter between private parties) were Gazetted by the Minister; all objections were to the proposed fees. These are not small points, since they show that he does not understand how this complex Act works. The Investigation Panel, in a controversial report from which your consultant quotes very selectively, did indeed find major flaws in the regime. However the Panel did not question the technical capacity of the response organizations (surely the most important issue, from a sustainable development point of view) and, like every panel that has examined the issue of oil spill preparedness, it supported (a) a volume-based fee levied on oil shipped by water and (b) the responsibility of potential polluters to share the costs of preparedness.

Finally, the consultant's conclusions are untenable. He claims that this regime discourages "local pollution prevention". Where is his evidence? What, exactly, is he talking about? The focus of this regime is on achieving a high level of preparedness -- and it has been successful in doing that, in every part of the country. He seems to believe that local response contractors and cooperatives are somehow disadvantaged by the regime. This is untrue. CCG, polluters and the ROs use those contractors routinely in clean-up activity, and the ROs have

implemented training courses for them (as they are required to do under regulations). Far from discouraging them, they pay them per diems to attend the courses!

He makes the same kind of sweeping suggestion that oil companies make windfall profits as a result of this regime -- as if it were a fact. This was a concern of the airlines, in their objection to the fees back in 1995. They feared that a fee applied to imported oil transported by water would allow companies to increase the price of all oil, irrespective of source. There is, however, no evidence of such an effect in the marketplace; indeed, such evidence, if it were found to exist, would be of interest to the Competition Bureau.

I note that the Cowan report appears to have been mainly drafted before the recent ministerial decision on fees (announced April 3, 1998). It is therefore important, for completeness, to sketch the results of that decision.

The effect of the announcement was immediate, in stabilizing the regime and establishing an even higher degree of user support for it. In this, it has reinforced what has always been the view of most users that this regime is a cost effective and operationally efficient means of meeting the responsibility of potential polluters to contribute directly to the protection of the environment. Objectors and other key stakeholders reached agreement in principle in early June on outstanding commercial issues; in follow-up meetings, they are now close to final agreement on standards of transparency and an agreed pre-publication process for fees. We anticipate a high level of stakeholder agreement on the governance issues, to be addressed in a public paper to be released later this summer. The regime is stable and effective.

Thank you again for this opportunity to comment on this report. If you would like a briefing on the regime, I would be most happy to oblige.

Sincerely,

S.A. Troy
Acting Director,
Environmental Response

TREASURY BOARD'S COMMENTS

Mr. John Dauvergne
Senior Policy Analyst
Environmental Affairs Branch
Industry Canada
7th Floor
235 Queen Street
Ottawa, Ontario
K1A 0H5

Dear Mr. Dauvergne:

Subject: The Implications to Competitiveness and Sustainable Development of Environmental Cost-Recovery Initiatives of the Canadian Federal Government: A Study Prepared by Cowan Research Inc.

Thank you for the opportunity to review and comment on the above-mentioned study. My comments, both general and specific, are limited to the major issues raised in the study regarding the Treasury Board *Cost Recovery and Charging Policy*.

GENERAL COMMENTS

- In April 1997, the government announced a new federal policy entitled *Cost Recovery and Charging Policy*. It emphasizes effective and meaningful consultation, client participation and accountable delivery of programs and services. Our early experience with this policy has been positive. In implementing this policy, departments or agencies and industry are discussing ? to an unprecedented degree ? issues such as client needs, service standards, and the cost, the quality and appropriate level of services.

- The Cowan study can be considered a useful vehicle for furthering dialogue between industry and federal departments and agencies. It identifies some of the specific concerns of industry and also demonstrates the importance of an open exchange of information for the successful implementation of cost-recovery. The study could be improved, however, with the addition of some empirical data and analysis to substantiate some of the statements and conclusions that it offers.

- Stakeholder interests are diverse and quite often at odds. As consultations on new regulatory initiatives proceed (including cost recovery), the first impression participants and outside observers may receive is that the process is one of disagreement and controversy. All parties should keep in mind, however, that this is the result of the openness of the process, the sharing of information, and the ability of interested parties to make their concerns known. Indeed, active dialogue is taking place between departments and industry on some of the user-fee initiatives discussed in the study (e.g. New Substance Notification and Export/Import of Hazardous Wastes).

SPECIFIC COMMENTS ON CERTAIN STATEMENTS AND CONCLUSIONS MADE IN THE STUDY

"Ministers are getting dragged into the details of their own initiatives, and those of other Ministers."

- Ministers are responsible for establishing or amending user charges within their areas of responsibility in accordance with their legal authority and government policy. Where the implementation of user charging affects other areas, it is appropriate that other ministers get involved. Indeed, most new user charges require the consideration of Treasury Board ministers.

"The Treasury Board policy provides no practical guidance on how to address the issue. ***The government should provide more guidance to agencies before cost-recovery initiatives are implemented, to reduce the pressure being put on individual Ministers."***

- The Treasury Board *Cost Recovery and Charging Policy* provides an overall framework. The policy sets out principles; it does not provide a detailed set of rigid rules to bind departments. It was deliberately designed to ensure that departments and agencies would retain sufficient flexibility to develop approaches that are appropriate to their environment and responsive to their clients' needs.

- The Treasury Board of Canada Secretariat developed the April 1997 policy in close consultation with other government departments and industry. The reaction to the policy has been largely favourable.

- Of course, each cost recovery proposal brings its own issues and challenges. Implementing fees where none existed before, or increasing fees, will always be

controversial to some extent. No set of rules or guidelines can ensure that this does not happen. Following the principles set out in the *Cost Recovery and Charging Policy*, however, should assist all parties in minimizing disagreement by achieving a level of trust and a common understanding of the issues.

"The issue of deciding whether regulatory programs provide public or private benefits, and how much of each, is a stumbling block to implementation."

- Most government activities generate a mix of public and private good. Identifying and quantifying the two is not straightforward. There are no easily applicable formulae. In practice, government departments, agencies and their stakeholders have addressed the appropriate allocation between private and public benefits through consultation, information sharing and the application of common sense. (Very few government programs are 100 per cent cost-recovered. Most user charges cover less than half of program costs.)

"At least four of the six cost-recovery initiatives will levy charges in situations that may affect the competitiveness of Canadian firms in the market place."

- One of the TB *Cost Recovery and Charging Policy* implementation requirements is to ensure that departments conduct an impact assessment, which includes factoring in the **cumulative** effect of fees from all federal sources. This is by no means a straightforward exercise. It will require a good deal of co-operation from stakeholders, for instance. Also, it is a methodologically new and challenging area.

"Cost-recovery just avoiding painful budget cuts, no limits to increases"

- This is a misconception common among commentators who are not familiar with the various checks and limits set on user charging and the ability of departments

to spend revenues. Policies and processes are in place to ensure that proposed fees are appropriate and that the fee-setting process is in line with the *Cost Recovery and Charging Policy* principles.

- The *Financial Administration Act* provides that fees for a service must be no more than the cost of providing the service. Furthermore, the *Cost Recovery and Charging Policy* states that charging cannot be used simply as a means of generating revenue to meet the funding requirements of a department or agency. There must be a relationship between the fee charged and the cost of the good or service, or the value of the service provided to clients.

- The policy represents a firm commitment by the government to client participation and accountable delivery of services in partnership with clients. As a result, user fees are taking their place as one tool for the equitable, efficient and effective delivery of federal services. Charging users is consistent with smaller, more affordable government. It promotes the delivery of quality services to Canadians and accountability in the use of taxpayers' dollars.

Thank you for the opportunity to comment.

Yours sincerely,

Len Endemann
Director
Cost Recovery Policy
Comptrollership Branch