



CANADIAN GLOBAL AFFAIRS INSTITUTE
INSTITUT CANADIEN DES AFFAIRES MONDIALES

Thoughts on Canada's Carbon Tax Agenda

by **Kenneth P. Green**
May, 2017

ENERGY SERIES

THOUGHTS ON CANADA'S CARBON TAX AGENDA

by Kenneth P. Green

May, 2017



CANADIAN GLOBAL AFFAIRS INSTITUTE
INSTITUT CANADIEN DES AFFAIRES MONDIALES

Prepared for the Canadian Global Affairs Institute
1600, 530 – 8th Avenue S.W., Calgary, AB T2P 3S8
www.cgai.ca

©2017 Canadian Global Affairs Institute
ISBN: 978-1-988493-35-0



Early in 2016, Canada signed on to the Paris climate agreement,¹ joining 129 other countries² in taking actions to limit climate change to 1.5-2C. To that end, Prime Minister Justin Trudeau adopted the previous Conservative government's greenhouse gas reduction targets. The goal is to reduce Canadian greenhouse gas emissions by 30 per cent from 2005 levels by 2030. Subsequently, several Canadian provinces and the federal government announced strong actions to reduce greenhouse gas emissions. The Alberta government rolled out its Climate Leadership Plan,³ which expands Alberta's carbon tax to the broader provincial economy and institutes a range of emission reduction programs, including a 100 megatonne annual cap on oilsands emissions. Ontario released its own Climate Change Action Plan⁴ and a cap-and-trade emission control regime aiming for an 80 per cent reduction in greenhouse gas emissions (from 1990 levels) by 2050. In August 2016, British Columbia, which already has a carbon tax, released its own aggressive Climate Leadership Plan,⁵ calling for an 80 per cent reduction from its 2007 emission levels by 2050. Finally, in October 2016, the Trudeau government announced⁶ that it will institute a pan-Canadian price floor for greenhouse gas emissions, to be imposed upon provincial governments that do not already have a program in place deemed to be equivalent with the federal price floor. That price floor will start in 2018 at \$30 per tonne of greenhouse gas emitted, rising to \$50 per tonne by 2022. All of these actions are poised to increase the costs of energy, a fundamental input to everything we do, manufacture, build, consume and export in Canada.

In the meantime, the United States presidential election has utterly shattered the idea that the U.S. will implement comparable greenhouse gas controls (through regulations rather than taxes), which would have eased concerns about Canadian competitiveness, even moving forward with carbon pricing. Prior to Donald Trump's election, one could rationally make the argument that the U.S. was likely to proceed on its greenhouse gas regulations, both those in progress and others expected to have come in under a Clinton presidency (thus imposing additional hidden taxes on the U.S. economy). It would have followed, then, for Canada's overt carbon tax to be seen as a superior approach that would not cause a marked economic imbalance between the U.S. and Canada, and even be less costly and more efficient than a regulatory model.

Several developments have changed all of that. First and foremost, we've seen that governments in Canada have no intention of instituting textbook carbon pricing. It is not revenue neutral, it does not displace existing regulations, and revenues are used in ways that distort the economy, rather than allowing the price to drive investment in the most efficient technologies.

Consider Ontario's cap-and-trade system⁷ instituted by Premier Kathleen Wynne, which her government estimated would bring in \$2 billion in revenue per year. According to the Ontario Auditor General,⁸ out of the \$8 billion, \$1.32 billion will be earmarked to help with residential and business electricity bills. The rest will be spent on the usual governmental preferences — transit, subsidies to renewable energy, dubious efficiency programs, etc. Cap-and-trade is basically a hidden carbon tax, and like a carbon tax, the only real way to mitigate against economic harm is to fully rebate revenue via reductions in distortionary taxes such as personal



and corporate income taxes. That's not going to happen in Ontario. And that's leaving aside the myriad problems with cap-and-trade systems in general.⁹

Or consider Alberta. Alberta's new carbon tax is \$30/tonne. Phased in by 2018, it is expected to generate some \$6 billion per year in revenues. Part of that will be used to subsidize Alberta's emitters (granting a windfall to the very people putting out most of the emissions). A small portion will be given to low-income Albertans, ostensibly to avoid the optics of having them freeze to death when power bills become unaffordable. The rest, \$2.6 billion/year, or 44 per cent of revenues will be spent on government pet projects.¹⁰

And then there's Quebec, which also has a cap-and-trade system that has brought in \$330 million, but is expected to bring in \$2.5 billion by 2020 (and probably more, as it will have to match the escalating national price floor established by the federal government). Where does the revenue go? Free permits are given out to emitters, while the remaining revenue is to be spent on "programs to fight climate change."¹¹

Finally, consider the much vaunted B.C. carbon tax. A new study by the Fraser Institute¹² verifies that indeed, in this tax's early years, it was truly revenue neutral. Personal and corporate taxes were reduced and additional tax reductions were introduced to ensure revenue neutrality. But by 2013/2014, only five years into the tax system, the government had taken to shaky bookkeeping to preserve the appearance, but not the reality of revenue neutrality. Indeed, when Fraser's researchers backed out some pre-existing tax credits that had been redefined as carbon tax reductions, the researchers found that the province actually netted \$226 million in 2013/2014, with a cumulative tax take of \$377 million for 2014/2015. Projecting forward, the researchers estimate a cumulative \$865 million tax increase by 2018/2019. That's about \$800 for a family of four. And a closer look at the details shows that rather than purely rebating revenues to the general population, diversions from those types of tax reductions began in only the second year with measures targeted at specific subgroups of the population. Those special interest tax credits rose from one in year two, to six by year seven, at which point \$148 million (12 per cent) of actual offsetting tax measures were being directed to specific sub-populations like: Northern and Rural Homeowner Credits; Children's Fitness Credit and Children's Art Credit; Small Business Venture Capital Credit; Small Business CIT; Industrial Property Tax Credits for Major Industry; Industrial Property Tax Credit for Light Industry; and School Property Tax Reduction for Farm Land.

So it is clear, in the new Trumpian environment, that the U.S. is poised to boost its energy economy. Canada is poised to contract its own, through carbon pricing and climate action plans that are inimical to provincial and federal economies, and to people's detriment in terms of higher prices for everything. Energy, certainly, will cost more, but so will the goods and services that rely on that energy to show up in the local market, including food. Because of those higher energy prices, more people almost certainly are heading for energy poverty¹³ under these plans.



What should Canada be doing? The first and most obvious actions Canada could take would be to postpone the implementation of the various climate action plans and carbon taxes, until analysis can be done to (re) evaluate the impact of those activities on Canadian competitiveness with a Trumpian U.S. economy. Little economic analysis was done on these plans to begin with (and what was done, government won't release¹⁴). It is probably too much to expect of policy-makers to actually retract their proposed climate action plans, but taking a breath to evaluate how U.S. developments will affect the impact of those plans should be justifiable even by the most ardent climate change advocate.

Canada can do other things on the climate front. There is little question that Canada will be affected by man-made and natural climatic changes. Indeed, one of the biggest lessons to have emerged from climate science research is that the climate is quite volatile, with many and subtle drivers, some of which are only weakly understood.

I wrote about this in an American context in *Climate Change: The Resilience Option*,¹⁵ a study I wrote for the American Enterprise Institute. In that study, I observed that governments can take many steps to mitigate actual climate risks, which are less related to the absolute change in atmospheric temperature and more related to derivative water-related risks such as sea-level rise, drought, flooding and so forth. In that paper, I discussed how government actions to compensate people who live in flood-prone areas tend to encourage people to take more risk than they might if they had to pay the full cost of insurance against rising sea levels or surface flooding. Market-priced insurance, phased in slowly over time, would gradually encourage people to move higher value properties and dense population areas away from the most climatically vulnerable places at the water's edge or in the bottom of flood plains. Similarly, shifting to fully priced and integrated private water systems can mitigate drought by guiding water where it needs to be, at the price needed to pay for its provision. Infrastructure can be protected through a combination of privatization and market pricing, which creates an information stream about which infrastructure is most important to people, and provides the revenues with which to protect it from climatic risk. This is true for energy infrastructure as well as for agricultural or pretty much any infrastructure. These actions will take time and certainly will require significant resources, but addressing the actual manifest risks of climate change (rather than the slight change in ambient temperatures) is more likely to protect people and property than is continued, largely futile action to significantly reduce greenhouse gas emissions.

That doesn't mean there is no room for government. Many of the privatizations I mentioned would likely be public-private partnerships that would require some government investment. And then, there is the question of research and development. It is well understood that the private sector under-invests in fundamental R&D at the levels of universities and national laboratories. But as analysts with the Breakthrough Institute¹⁶ point out, this type of R&D is exactly what's needed to pave the way for economic decarbonization. Until we can generate power and fuel mobility more cheaply than with carbon-intensive methods, and more reliably than current alternatives such as wind and solar power, we will see little progress on the kind of



massive decarbonization that Trudeau and other signatories to the Paris agreement pledged to achieve.

For now, while large-scale mitigation shows itself to be unsustainably expensive in country after country, leading to retracted carbon taxes,¹⁷ disruptive rollbacks of renewable subsidies,¹⁸ retreats from international carbon-reduction pledges,¹⁹ power blackouts²⁰ and growing levels of energy poverty,²¹ we should reconsider the overwhelming governmental focus on near-term mitigation of greenhouse gas emissions. We need to refocus some of that attention on the long neglected necessity to make Canada resilient to climate change, and ensure that Canadians are able to adapt to climate changes whether man-made or natural. By developing new, affordable and reliable forms of low-carbon energy production, and by powering more of the world with our abundant supplies of natural gas, we can also do our part internationally to help developing countries get off high-carbon fuels faster. These actions will have a greater impact on GHG reductions than Canada could ever have achieved acting alone.

¹ <http://www.cbc.ca/news/politics/paris-agreement-trudeau-sign-1.3547822>

² http://unfccc.int/paris_agreement/items/9444.php

³ <https://www.alberta.ca/climate-leadership-plan.aspx>

⁴ <https://news.ontario.ca/opo/en/2016/06/ontario-releases-new-climate-change-action-plan.html>

⁵ <https://climate.gov.bc.ca/feature/climate-leadership-plan/>

⁶ <https://www.thestar.com/news/canada/2016/10/03/justin-trudeaus-liberals-unveil-plan-to-price-carbon.html>

⁷ <https://www.ontario.ca/page/cap-and-trade-ontario>

⁸ <http://globalnews.ca/news/3097838/cap-and-trade-to-cost-people-business-8b-in-first-years-auditor/>

⁹ <https://www.aei.org/publication/climate-change-caps-vs-taxes/>

¹⁰ <http://www.cbc.ca/news/canada/calgary/carbon-tax-impact-consumers-business-1.3330391>

¹¹ <https://www.thestar.com/news/canada/2015/04/13/quebecs-cap-and-trade-system.html>

¹² <https://www.fraserinstitute.org/sites/default/files/examining-the-revenue-neutrality-of-bcs-carbon-tax.pdf>

¹³ <https://www.fraserinstitute.org/article/higher-energy-prices-fuel-energy-poverty-in-canada-especially-in-ontario>

¹⁴ <http://news.nationalpost.com/news/canada/canadian-politics/liberals-know-how-much-its-carbon-tax-will-cost-consumers-but-wont-tell-you>

¹⁵ <http://www.aei.org/publication/climate-change-the-resilience-option/>

¹⁶ http://thebreakthrough.org/archive/national_institutes_of_energy

¹⁷ <https://www.theguardian.com/environment/2014/jul/17/australia-kills-off-carbon-tax>

¹⁸ <http://www.jonesday.com/international-remedies-for-foreign-investors-in-europes-renewable-energy-sector-02-19-2015/>

¹⁹ <http://www.smh.com.au/environment/climate-change/kyoto-deal-loses-four-big-nations-20110528-1f9dk.html>

²⁰ <http://www.abc.net.au/news/2017-02-16/policymakers-need-to-act-quickly-after-sa-blackouts-prof-spoehr/8276572>

²¹ <https://www.fraserinstitute.org/studies/energy-costs-and-canadian-households-how-much-are-we-spending>

▲ About the Author

Kenneth P. Green is Senior Director of the Center for Natural Resource Studies at the Fraser Institute. He received his doctorate in Environmental Science and Engineering from the University of California, Los Angeles (UCLA), an M.S. in Molecular Genetics from San Diego State University, and a B.S. in Biology from UCLA. Mr. Green has studied public policy involving energy, risk, regulation, and the environment for nearly 20 years at public policy research institutions across North America including the Reason Foundation, the Environmental Literacy Council and the American Enterprise Institute. He has an extensive publication list of policy studies, magazine articles, opinion columns, book and encyclopedia chapters, and two supplementary textbooks on climate change and energy policy intended for middle-school and collegiate audiences respectively. Mr. Green's writing has appeared in major newspapers across the US and Canada, and he is a regular presence on both Canadian and American radio and television. Mr. Green has testified before several state legislatures and regulatory agencies, as well as giving testimony to a variety of committees of the US House, US Senate and the House of Commons.

Canadian Global Affairs Institute

The Canadian Global Affairs Institute focuses on the entire range of Canada's international relations in all its forms including (in partnership with the University of Calgary's School of Public Policy), trade investment and international capacity building. Successor to the Canadian Defence and Foreign Affairs Institute (CDFAI, which was established in 2001), the Institute works to inform Canadians about the importance of having a respected and influential voice in those parts of the globe where Canada has significant interests due to trade and investment, origins of Canada's population, geographic security (and especially security of North America in conjunction with the United States), social development, or the peace and freedom of allied nations. The Institute aims to demonstrate to Canadians the importance of comprehensive foreign, defence and trade policies which both express our values and represent our interests.

The Institute was created to bridge the gap between what Canadians need to know about Canadian international activities and what they do know. Historically, Canadians have tended to look abroad out of a search for markets because Canada depends heavily on foreign trade. In the modern post-Cold War world, however, global security and stability have become the bedrocks of global commerce and the free movement of people, goods and ideas across international boundaries. Canada has striven to open the world since the 1930s and was a driving factor behind the adoption of the main structures which underpin globalization such as the International Monetary Fund, the World Bank, the World Trade Organization and emerging free trade networks connecting dozens of international economies. The Canadian Global Affairs Institute recognizes Canada's contribution to a globalized world and aims to inform Canadians about Canada's role in that process and the connection between globalization and security.

In all its activities the Institute is a charitable, non-partisan, non-advocacy organization that provides a platform for a variety of viewpoints. It is supported financially by the contributions of individuals, foundations and corporations. Conclusions or opinions expressed in Institute publications and programs are those of the author(s) and do not necessarily reflect the views of Institute staff, fellows, directors, advisors or any individuals or organizations that provide financial support to the Institute.