

NATIONAL AFFAIRS

Canada

Taxation and Other Policies to Reduce Greenhouse Gas Emissions and Enhance Competitiveness*

by Charles Caccia**

With regard to the meaning of “competitiveness” I believe we should evaluate the word within a broad social context. One could argue, for example, that competitiveness could be improved by eliminating minimum wages or by allowing child labour. But we all know this is not the case. The gains that might be achieved by paying people less than the minimum wage are short term: their spending power would be reduced, they would probably have to seek lodging in public housing, and they would increase the number of people calling on food banks. As for child labour, it would lead to lower levels of education, a shortage of skilled workers, greater poverty, insecure employment and marginalisation in adulthood.

Another claim, heard from time to time, is that competitiveness could be enhanced through the elimination of environmental regulations. Voluntarism, some say, is a better answer but studies show that this approach is ineffective and unfair. Some companies would adopt environmental regulations, others would not. In some areas, then, you would have decent air quality and in others, not. Admissions to hospitals due to respiratory diseases caused by smog would be low in cities where voluntarism works and high where it does not. The resulting healthcare costs in those places where companies do not adhere to environmental regulations would then become a burden on the economy and in turn affect competitiveness with countries whose workforces as a whole enjoy good health standards.

There is clear evidence that countries with strong environmental regulations are at the same time very competitive because economic performance depends on a healthy workforce and health depends on the quality of life and the environment. According to the World Health Organisation, disease caused by environmental factors is considerably less in countries with strict environmental regulations (i.e. Sweden, Denmark) than in those countries with less stringent controls (i.e. China, Mexico).

Studies conducted over the past 30 years on environmental regulations and competitiveness show that firms

do not lose their competitive advantage as a result of environmental regulations. “On the contrary, there is evidence that companies that are looking at [the environment] are doing better,” says Dan Bakal, director of outreach for the Coalition for Environmentally Responsible Economies (CERES), a Boston-based coalition for environmental responsibility. A study published in the journal *Management Science* in August 2000 found a relationship between market value and environmental responsibility in multinational companies. Companies on the Dow Jones Sustainability Group Index (DJSGI), a set of indices that ranks companies on their sustainability practices, regularly outperform their conventional counterparts.

Business leaders are taking note. In a speech to CERES in April 2000, Bill Ford, great-grandson of Henry Ford and now chairman of the board, said that Ford’s participation in environmental programmes has “confirmed my strong belief that – in addition to being the right thing to do – preserving the environment is a competitive advantage and a major business opportunity.”

Introduction

The timing of this conference could not be better as this is the year in which Canada and the global community is expected to ratify the Kyoto Protocol. While the topics included in this conference are wide-ranging, they are all related to policies designed to reduce greenhouse gas (GHG) emissions – urgent items indeed.

Relying as we do on fossil fuels, it is no wonder that we in the industrialised world have been wrestling with the issue of climate change and its cause for a decade and a half. In 1988, the scientific community warned us, right here in Toronto, that a major problem existed. The United Nations debated this issue at the time of the publication of the Brundtland Report. One after the other, presidents of the island States in the Pacific Ocean have urged the global community to take action in order to prevent a rise in ocean levels. In Rio, at the UN Conference on Environment and Development in 1992, one Head of State after the other referred to the looming dangers to be expected from GHG emissions resulting from fossil fuel consumption. Political parties have adopted climate change as a theme in their appeals to voters at election time. The Or-

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** M.P. (Davenport) and Chair, House of Commons Standing Committee on the Environment and Sustainable Development.

ganisation for Economic Co-operation and Development (OECD) – certainly not a haven for rabid environmentalists – has repeatedly drawn the attention of its member nations to the problem. So has the Council of Europe, the EU parliament in Brussels, and all major governments the world over, including the parliament in Ottawa and the municipal government here in Toronto.

Why, then, is there so little progress? A partial answer can be found in reading the titles of Workshops A and B of this conference. One reads: “How to Structure the GHG Transactions and Develop Offers to Bring to Market” and the other, “How to Contract in GHG Emissions Trading”. Important topics, no doubt, but only useful if we also address more fundamental challenges such as: “How to reduce GHG emissions” or “How to share environmentally beneficial technologies with developing countries”.

Another answer is that Canada is both a developed and a developing economy. In the East we are industrialised and rely on imported oil while in the West the economy is based on natural resources and their export. For politicians in Ottawa, this duality poses a problem in the search for what is possible, assuming that to be the art of politics.

We also have a global problem, one that can be explained by the fact that it is not easy to change course, having travelled for almost two centuries on a supertanker which supplies us with apparently all the energy we need. The supertanker has a large momentum and turning it around is no simple task. We are still negotiating on how to turn it around and the crew is not unanimous on how to do that.

What is to be done? In my talk today, I will present to you measures that could be implemented to achieve this “turning around”, beginning with taxation.

Taxation

The need for a level playing field for energy investments

What I am supposed to cover in this address is not the ultimate in political excitement, namely the current taxation system in Canada aimed at meeting Canada’s Kyoto commitment. Actually, not much can be said.

What we have are bits and pieces, as in the case of last December’s budget which contains one item on wind energy – an incentive payment of 1.2 cents per kWh of production intended to encourage the development of green energy. Going back to the 1999 budget, you find another encouraging (but tiny) item, namely the extension of the seven per cent tax credit for manufacturing and processing to companies that produce, for sale, electrical energy or steam used in generating electricity. But that is all.

By contrast, in the 1992 and 1996 budgets, incentives were introduced that actually resulted in greater and subsidised GHG emissions. Two of these incentives, as outlined in the 2000 Report of the Commissioner of the Environment and Sustainable Development, are:

- Income tax rules for accelerated write-offs for new mines and major mine expansions, including oil sands.

- New tax rules to write off tangible capital expenses for oil sands in situ projects under the more generous tax rules for mining.

As you can see, in recent years taxation related to GHG emissions has taken tiny steps in the right direction and giant steps backwards. Several major initiatives need to be taken if we are to reduce GHG emissions and dependence on fossil fuels. For example, we have to level the so-called playing field – presently weighted in favour of non-renewables. The removal of perverse subsidies to the oil sands industry figures prominently in this respect and requires urgent attention. CO₂ emissions from oil sands operations are on average 22 per cent higher than emissions from an equivalent amount of crude oil production. The generous write-offs for property and pre-production development expenses afforded to this industry under the mining provisions of the Income Tax Act can no longer be justified, economically or environmentally, if the government is committed to reducing Canada’s GHG emissions.

Introducing incentives for investments in renewable energy sources

Now let us look at the absence of substantive and imaginative tax measures and fiscal incentives to attract investment in the renewable energy sector. The renewable energy sector is handicapped because it cannot use the generous exploration, development and operating write-offs available to the non-renewable sector. Bringing renewable energy to the commercialisation stage poses particular challenges yet to be recognised in our corporate tax system. While the tax system may appear to treat the renewable and non-renewable energy sectors almost similarly on paper, in reality, the two sectors are impacted by tax provisions very differently. In my view, the following recommendations should be given serious consideration: (1) Change the interaction between the federal and provincial tax systems and the applicable provincial royalty regimes so as to remove the preferential tax treatment to the non-renewable sector and (2) Eliminate the exploration, development and operating write-offs accorded to the non-renewable energy sector.

Having removed these perverse subsidies and the preferential tax treatment to the fossil fuel industry, the next step would be the establishment of preferential tax treatment for the renewable energy sector in the form of flow-through shares and accelerated depreciation. This would include: an accelerated tax write-offs regime specifically designed to attract investments in the renewable energy sectors, a preferential tax treatment to reward energy efficiency projects, and a programme to encourage energy conservation, energy efficiency and the shift to cleaner fuels.

Let me point out that these recommendations are very much in line with the thinking of economists at the OECD. Its Economic Survey of Canada in 2000 concludes that resource-based sectors have benefited from preferential tax treatment from the federal and provincial governments.

This has encouraged the development of resource extraction activities, contributed to depressing costs and, to some extent, prices.

In addition, the OECD report points out that Canadian tax rates on oil and gas are barely one third of the tax rates imposed on the manufacturing sector and only one quarter of those imposed on most service sector activities. What more evidence is needed to prove that Canada's corporate income tax regime favours non-renewable sources?

To sum it up, the issues of taxation identified by the OECD, the absence of a level playing field (such as perverse subsidies to the fossil fuel industry) and the virtual absence of strong incentives all put together constitute a massive obstacle to a substantive decrease in the GHG emissions we are concerned about.

Other factors

Other examples of how the demand for renewable energy sources could be influenced include:

- The recommendation in the 15 December issue of *The Economist* to strengthen the Corporate Average Fuel Economy (CAFÉ) standards. This would result in more fuel-efficient cars and close loopholes for light trucks and SUVs (sports utility vehicles).
- In the Arctic, considerable savings could be achieved by switching partially or entirely from diesel to wind for electricity generation – already, there is the tax incentive of 1.2 cents per kilowatt-hour.

An aspect of the taxation system which has an adverse effect on the reduction of GHG emissions is the unfair treatment of people who use public transport to get to work compared with people who drive to work. Parking is considered a taxable benefit if an employer purchases a parking space (at market value) for an employee. An employee, however, must pay income tax on an employer-provided transport pass. The government's logic behind this idea is that if the employee is enjoying the benefit of the pass, he or she should be responsible for the tax. It is not only the employee, however, who is enjoying the "benefit" of taking public transport. The environment, the economy and society as a whole enjoys the benefits of people taking public transport instead of driving to work.

The issue of taxation is important for the reduction of GHG emissions because it signals a policy commitment by the government. But there are other important policy considerations outside taxation.

- The constraints imposed by the fact that much of the business community still sees the reduction of GHG emissions as a cost to society. We seem to be paralysed by the recalcitrance of certain powerful interests, which so far have succeeded in focusing the debate on costs, overlooking solid research and practical evidence of the benefits.
- The fact that energy efficiency is good business and beneficial to the economy.
- The fact that energy conservation is desirable both environmentally *and* economically. In this regard, by

the way, considerable ground was lost when creative programmes, established by the Canadian government in the '70s and early '80s, were dismantled in the late '80s, even though they resulted in demonstrable reductions in energy consumption.

- Some tentative steps have been taken recently, but they are far from adequate. For example, Technology Partnerships Canada, recently introduced, might be able to attract investors to the renewable energy sector, but it is far from being an adequate policy instrument.
- Methane produced from landfills can be converted for district heating, when we are able to form working partnerships between levels of government, as demonstrated by the power stations at Brock West and Keele Valley landfills near Toronto.

It can actually be argued that the benefits *could* be greater than the costs – we have not even started to quantify the benefits to health, quality of life and the long-term economy. Certain economic benefits to Canada, for instance, have been lost to other nations by not becoming a major producer and exporter of renewable energy technologies. For example, we lost the windmill market to the Danes, although Canada was a leader in this technology in the 1980s.

The cost of inaction

Perhaps it is time to start asking questions about the cost of not acting, the cost of postponing, the cost of more studies. With temperatures several degrees above normal levels, the costly impact of climate change as caused by GHG emissions is beginning to become alarming. All we have to do is to listen. Representatives of the shipping industry report about the economic impact of lower water levels in the Great Lakes; the insurance industry is facing negative economic effects of abnormal weather patterns; more recently, the tourism industry, be it Winter events depending on ice and snow or Summer events depending on water levels; people living in the Arctic talk about the reduction in ice surface and thickness, changes in wildlife behaviour and the impact on hunting activities; farmers face the prospect of drought and forest fires; science-based predictions of Polar Cap melting and its potential effect on millions of people living on the island States in the Pacific and coastal Bangladesh, threatened by rising sea levels, etc.

Balancing vs. integrating

This two-day conference examines many facets of the GHG emissions issue and the organisers are to be commended. Almost every nook and cranny of this issue is being put under the microscope. Tomorrow, for instance, a workshop will discuss the financing of initiatives for the reduction of GHG emissions, a laudable and most desirable effort. The explanatory note in the programme indicates the financial group in question is committed to "supporting the balance between a sound

economy and responsible environmental and social practice.” What balance? – I asked myself.

You may recall the Brundtland Report on Sustainable Development urges the integration of economic goals with social and environmental goals. A sound economy, therefore, is founded on a healthy environment. Hence, a sound economy cannot be a balancing act. If we engage in balancing acts, we inadvertently create an antagonism, a decoupling of economic values on the one hand from environmental and social values on the other. We thus create a false dichotomy, false because, as we have learnt in recent decades, the economy and the environment are actually one and the same integrated force and should definitely not be seen as competing or balancing with each other. All this may sound like conceptual claptrap but is not. The balancing concept has in the past led to air pollution, water quality damage, deforestation, the exhaustion of fisheries, the hole in the ozone layer, etc.

And it is again the concept of balancing which is compelling us to wrestle with GHG emissions. Integrating the environment and the economy is by far preferable to the balancing act. In the case of climate change we have to integrate the reduction of GHG emissions in a coherent taxation policy.

The World Bank

Canada’s position on GHG emissions reduction is ambivalent. It can be described as someone trying to ride two horses galloping in opposite directions. One horse

Now you may think Canada is unique in this contradiction, but we are not. The World Bank, which features a speaker tomorrow, is in the same predicament. At the Earth Summit+5 in New York in 1997, the World Bank’s President pledged to calculate GHG emissions from World Bank energy projects and “where there is cause for concern, explore more climate-friendly options”. However, according to the Institute for Policy Studies in Washington, that pledge has proven hollow. Fossil fuel financing by the World Bank Group since 1992 amounts to \$20.8 billion. Renewable energy/energy efficiency financing by the World Bank Group since 1992: \$900 million. Number of World Bank Group renewable energy/energy efficiency projects since 1992 is 30. The number of fossil fuel projects since 1992 is 212. The top three recipients of World Bank fossil fuel aid since 1992 are India, China and Russia with a total of \$8.9 billion. Evidently, the World Bank is also riding horses galloping in opposite directions – the fossil fuel horse obviously much bigger, stronger, well-fed and nourished than the energy efficiency horse. Perhaps tomorrow the World Bank speaker might be able to offer a helpful explanation of this contradiction, not uncommon in other jurisdictions.

Conclusion

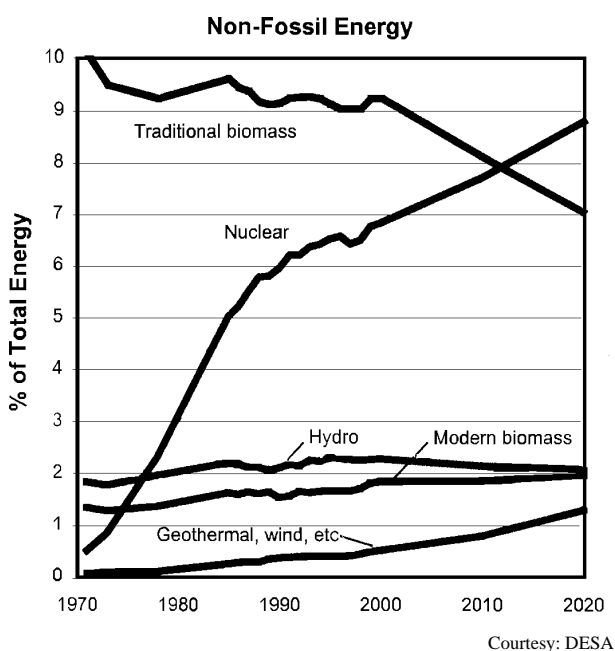
Let me conclude by saying the problem posed by GHG emissions: (1) cannot be solved by simply throwing money at it and (2) offers tremendous opportunities to enhance competitiveness.

It follows that:

- benefits accruing from GHG reductions need to be recognised and promoted.
- Attention needs to be shifted from managing supply to managing demand (our insatiable consumption of energy needs to be reined in).
- The increasing damage to the insurance, shipping and tourism industries, soon to be followed by agriculture and forestry, requires urgent action.
- Renewables must be given a fair chance to succeed through favourable tax treatment.
- Perverse subsidies must be phased out.

With six billion inhabitants living on this planet today and a population likely to double in the next century, we have an obligation to act on behalf of future generations to ensure a safe environment. Kenneth Boulding’s image, that “we are acting like cowboys on a limitless open frontier when we actually inhabit a living spaceship with a limited life-support system”, captures perfectly the predicament we face. Evidently, we must put more emphasis on the *benefits* of reducing GHG emissions and less emphasis on the *costs*; more emphasis on conservation, less on supply; more emphasis on renewable energy and less on fossil fuels. And finally, on designing an energy and taxation policy in which climate change is fully integrated.

Simply put, if we are to reach the goal of reducing GHG emissions, the two horses must gallop in the same direction.



pulls energy investments towards the fossil fuels sector, thus increasing GHG emissions. The opposite horse pulls programmes and policies aimed at reducing GHG emissions.