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THE RIGHT WAY TO TAX CARBON: FOLLOW THE GST MODEL

The federal government's intention to gradually increase its tax on carbon to $50 per tonne by 2022 has potentially major implications for a handful of industries, most notably aluminium, metallurgy, cement and oil and gas. The most recent estimates put Canada's annual carbon dioxide production at 730 million tonnes (Mt). Aside from transportation (23 per cent), agriculture (10 per cent), electricity production (11 per cent) and buildings (12 per cent), the aforementioned trade-exposed industries are responsible for most of Canada's remaining emissions (37 per cent).However, there is a way to limit the damage. The tax should be structured using the same logic as the GST — levied on the value firms add to goods and services. An optimal carbon tax should thus be based on the amount of carbon dioxide produced at each stage of production and be paid by the buyer of a product to the seller. Like for the GST, each seller would be reimbursed for the tax already paid to their own suppliers and would remit to the government the surplus in taxes collected.There should be no exemptions allowed for locally sold goods and services but, like for the GST, exports would be exempt from the tax, preserving our export competitiveness on foreign markets. By the same token, to be fair, imports would be taxed based on their total carbon content (including the fuel used in the transportation of the goods to Canada). Here are a few examples to illustrate why this is important.

Canada produces annually 4 Mt of aluminium, mostly exported. Aluminium smelting generates approximately 1.6 tonnes of carbon dioxide per tonne of aluminium, resulting in 6.4 Mt. At $50 per tonne, Canadian smelters' yearly carbon tax bill would be $320 million.On the other hand, Chinese smelters are not subject to carbon taxes. Moreover, unlike Canadian producers using hydroelectricity, China mostly uses coal, which considerably adds to its carbon footprint. Should Canadian producers lose their competitiveness through taxation, Canada would lose jobs, and harmful emissions would likely increase globally. More problematic is the case of the Canadian metallurgy industry. The sector still produces 13 Mt of steel, more than 50 per cent of which is exported. This production of steel generates approximately 21 Mt of carbon. A $50 tax would create additional charges of roughly $80 per tonne of steel. With steel at a price of $750 per tonne, the surcharge would be over 10 per cent, significantly reducing the competiveness of our steel industry.Canada also produces approximately 13 Mt of cement per year, of which a quarter is exported. With 12 Mt of carbon emissions, the carbon tax would represent 35 per cent of the value of cement, making exports non-competitive.In Quebec, the prevailing cap-and-trade system – soon to be extended to Ontario – virtually excludes aluminium, cement, steel, oil refining, mining, pulp and paper and other sectors from the auction systems as they are getting free carbon quotas.

The exclusions appear essential in light of the above examples. Take the case of B.C., where there already is a $30 carbon tax applicable to all sectors. Last year, the B.C. government had to step in and provide $22 million to support the cement industry faced with increased foreign competition.Now for the elephant in the room: oil. Canada produces approximately more than 3.8 million barrels of crude oil per day and exports 80 per cent of it. Total greenhouse gas emissions by the oil and gas sector (192 Mt annually and 26 per cent of the Canadian emissions) are also expected to continue growing.

The proposed carbon tax would add approximately $4.50 to the cost of each barrel of oil and may spell more troubles for an already battered industry. If the global oil industry is not subject to the same tax treatment on carbon emissions, Canadian oil may simply be replaced, here and abroad, by cheaper untaxed foreign oil.Surely, innovation will come, and pricing carbon will stimulate innovation and reduce emissions. But, in the meantime, it will be harming our economy without really

reducing global emissions; hence the dilemma.However, implementing a carbon-added tax on end-users instead of the proposed $50 carbon tax on local production could achieve global emission reductions without harming domestic growth. Critics have argued that this may be too complex, create barriers to trade or go against WTO rules. Yet, rigorously accounting for emissions and making sure the WTO adapts to the reality of climate change are essential if we are serious in wanting to limit emissions. For instance, in the spirit of the current agreement, members of the WTO could agree that countries that fail to tax carbon are providing unfair subsidies to their producers. Because the carbon-added tax alternative would not reduce one country's competitiveness vis-à-vis its trading partners, it would also create incentives for these partners, if keen on reducing emissions without harming their domestic industry, to follow in Canada's footsteps.We don't know yet how such a GST-type alternative could be successfully implemented. However, you can expect that, under its proposed form, the $50 carbon tax won't achieve its objectives.