Business Council *of* British Columbia

Submission on the Provincial Carbon Tax

September 5, 2012

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British Columbia

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SUBMISSION ON THE PROVINCIAL CARBON TAX

The Business Council of British Columbia is pleased to make this submission on the current structure and future role of the province's carbon tax. By way of background, the Business Council is a cross-sectoral association representing some 250 large and mid-sized enterprises engaged in business in the province. Collectively, the Council's member companies and affiliated industry associations account for approximately one-quarter of all private sector jobs in British Columbia. Environmental and energy policy issues have been a significant focus of the Business Council's research and advocacy work in recent years.

In the 2012 Budget, the Ministry of Finance announced a review of the carbon tax and its impact on British Columbians. As described in the Budget, "the review will cover all aspects of the carbon tax, including revenue neutrality, and will consider the impact on competitiveness of BC businesses..."[1]

Important changes have occurred since BC enacted North America's first broadly-based carbon levy in July 2008, both in the macro-economic environment and in the evolution of carbon management and other climate policies across different jurisdictions. The Business Council welcomes the government's decision to take a fresh look at the carbon tax. This submission will detail a number of factors relevant to that review, and then provide some recommendations for consideration by the Ministry of Finance and, ultimately, the government as a whole.

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[1] Province of British Columbia, *Ministry of Finance Budget and Fiscal Plan – 2012/13 to 2014/15*, p. 66.

As a preliminary point, most Business Council members, in common with Canadian business leaders generally, agree with the concept that society should put a "price" on activities that are deemed harmful to the environment – including greenhouse gas (GHG) emissions believed to contribute to anthropogenic climate change. This principle was recently articulated by the Canadian Council of Chief Executives,[2] and it is broadly supported within our membership. The difficulty for government decision-makers, particularly in a small jurisdiction like British Columbia, lies in translating this principle into sound policy. For while it is appropriate that BC do its part to help address the long-term global problem of climate change, it doesn't make sense to institute policies that impose excessive or needless costs on our citizens, or that disadvantage our businesses and entrepreneurs in a competitive context by encouraging industrial investment and production to contract in BC and migrate to other jurisdictions.

As a further initial comment, the Business Council believes it is a mistake to concentrate on the carbon tax to the exclusion of the broader set of climate polices initiated by the government in the 2007 Throne Speech, and elaborated in subsequent legislation and policy. To this end, we urge the government to think more holistically about the linkages between its climate change plan and its other key goals and policies, including those directed at furthering economic development and prosperity. While this submission focuses primarily on matters within the purview of the Ministry of Finance, we have also included some analysis and advice on how to better reconcile the climate change agenda with economic realities and economic development opportunities – both domestically and globally.

<u>Assessing the BC Carbon Tax</u>

While the 2007 Throne Speech launched no fewer than 30 initiatives across the climate change policy spectrum – from GHG targets to a clean energy fund – it was in the 2008

[2] See Canadian Council of Chief Executives, *Clean Growth 2.0: How Canada Can be a Leader in Energy and Environmental Innovation,* November 2010 (available at: www.ceo.council.ca).

Budget that BC presented its proposal to price carbon through a widely-applied tax.[3] Unbeknownst to policy-makers at the time, the economic setting in which the province's climate change initiatives would be carried out was about to be disrupted. Shortly after the carbon tax was enacted, the world entered the most serious economic crisis since the Great Depression. The challenges posed by the global financial crisis and economic downturn of 2008-09 – and the slow and halting recovery that has followed in its wake – cannot be overlooked. These developments have led to marked shifts in the economic and public policy landscape, including for climate change and carbon management programs.

Instead of a fiscal, economic and global political environment that would have enabled a smoother transition to a world where carbon is priced efficiently and equitably among trading partners, BC has ended up being isolated within North America with respect to carbon pricing. The changing context around climate policy includes the following elements:

1) Stalled momentum in North America for carbon-pricing:
    a. failure to transition to a "cap-and-trade" system under the Western Climate Initiative (WCI);
    b. failure of the US government to move forward with any direct carbon pricing policy; and
    c. Canadian voters' rejection of a national carbon pricing regime in the 2008 federal election.
2) Negative impacts of the BC carbon tax on some energy-intensive/trade-exposed industries and on the overall competitiveness of significant parts of our export economy.
3) Slowing of the transition to renewable energy, in part due to economic circumstances, but also because of falling natural gas prices.

[3] For a comprehensive list of policy initiatives see the government's News Release '*Throne Speech Launches B.C. into the Pacific Century*' February 13, 2007. http://www2.news.gov.bc.ca/news_releases_2005-2009/2007OTP0014-000128.htm.

4) Massive continent-wide shale gas energy finds, including in BC.
5) The significant opportunities that have emerged, globally and in BC, for LNG development.
6) The Canadian government's decision to base its policy regime for addressing GHG emissions on sector-specific targets and plans and to eschew any kind of carbon pricing scheme.

We discuss each of these factors in greater detail below.

Stalled momentum for carbon-pricing

a. Failure to transition to "cap and trade" under WCI

Broadly speaking, the policies available to price carbon include: 1) A carbon tax levied on GHG emissions, typically in proportion to the carbon content of fossil fuels used. 2) A trading system ("cap and trade") that limits total emissions for specified industry sectors, with designated emitters required to have allowances to cover their emissions. These allowances are tradeable, and subsequently a market price emerges as sales occur among emitters. 3) A regulated model, whereby covered entities and sectors ensure compliance with targets set by government, based on some combination of altering their production systems, reducing output, purchasing allowances, or making compensating payments for excess emissions at an established price.

A core feature of the 2007-08 BC approach to carbon pricing was the use of a blended, transitional model, whereby the province's carbon tax for larger (reportable threshold) emitters was expected to shift fairly quickly to a "cap and trade" regime developed through the Western Climate Initiative (WCI) process. This meant that BC industries would not be put in a position of "paying twice" for their GHG emissions. Reportable emitters in a cap and trade world would either be exempt from paying the carbon tax, or else receive some form of grant/rebate to offset the economic impact of a higher carbon price charged in British Columbia.

From both competitiveness and "carbon leakage" perspectives, the expected transition to a WCI cap and trade model was an important feature of the BC policy framework. And in this connection, it must be stressed that for BC industries with relatively significant exposure to GHG cost differentials in their trading markets (domestic and export), the carbon tax has created an economic disadvantage. The precise magnitude of that disadvantage depends, *inter alia*, on the nature of the BC industry's production technology, the cost of available GHG abatement options, the level of the carbon tax, and the specific competitors that the BC industry faces in the markets where it does business. The WCI would have addressed some of these cost differential issues, by "leveling the playing field" among WCI-based industries, and also by allowing for a more coordinated position on the treatment of industries located in non-WCI jurisdictions.[4] While this submission does not explore the strengths and weaknesses of the proposed WCI scheme, it is clear that the failure to transition to the WCI cap and trade system has implications for the province's competitive position – and particularly for what are often referred to as energy-intensive, trade-exposed industries (EITEIs).

b. Failure of US federal government carbon pricing initiatives

The Obama administration arrived in office after the 2008 US elections with a basic plan and a perceived mandate to price carbon. However, its attempts to advance major policy initiatives in this area were unsuccessful. The 2009 Waxman/Markey bill narrowly passed the House of Representatives but was blocked in the Senate the following year. Subsequent legislative initiatives have stalled, and the administration has essentially given up seeking Congressional support for any kind of substantive

[4] These important issues are taken up, in a US context, in a 2008 study that explores various ways to "level the playing field" for energy-intensive domestic industries in a world where only some jurisdictions are committed to pricing carbon. See Peterson Institute for International Economics and World Resources Institute, *Levelling the Carbon Playing Field: International Competition and US Climate Policy Design*, 2008.

climate policy. Instead, the US government has focused its efforts on renewable energy incentives, the development of more stringent vehicle fuel efficiency standards, and other regulatory measures aimed at tackling industrial greenhouse gas emissions.

The US is Canada's and British Columbia's single largest trading partner, so how it proceeds on climate change necessarily has important economic, competitive and environmental implications on our side of the border. In 2008-09 BC's climate change agenda was tightly coupled with what, at the time, was seen as a similar *draft* policy agenda being developed by the Obama administration. As with the WCI's largely stalled cap and trade plan[5], the failure to move forward with a US carbon pricing system has exposed a number of BC industries to marketplace disadvantages, while not offering the protective remedies available in other jurisdictions that have adopted carbon pricing regimes.

c. *Canadian voters reject a nation-wide carbon tax*

The 2008 federal election was fought around a number of competing visions for the country, but one central issue was the carbon tax proposal advanced by the federal Liberal Party. While it is unclear to what extent this contributed to the Liberal Party's poor showing in 2008, it is fair to say that the outcome of that election dampened any momentum that may have existed – then or subsequently – to pursue a <u>national</u> carbon pricing policy.

In combination, the lack of any movement towards comprehensive carbon pricing by British Columbia's key continental trading partners has isolated the province and created competitive headwinds for some of our industries, particularly EITEIs. Although examples of carbon pricing have taken hold in some other – mostly distant – jurisdictions (the

[5] While California and Quebec are apparently planning to launch cap and trade programs in 2013, many uncertainties remain as to how and whether these schemes will work. In addition, all of the other US states originally involved in the WCI process have now withdrawn. Ontario is part of the WCI, but our understanding is that it will not be implementing a cap and trade program in the foreseeable future.

European Union, Sweden, Australia, and in future California), all of these jurisdictions have instituted policies to protect their EITEIs – something that British Columbia has failed to do. In fact, to our knowledge, BC is the only jurisdiction with a broad carbon tax/carbon pricing regime that does not also maintain a corresponding set of policies to guard against "carbon leakage" and manage risks to its export-focused and import-competing industries.

Impacts on Energy-Intensive/Trade-Exposed Industries (EITEIs)

As a relatively small province operating in a highly competitive global marketplace, the tax and regulatory burden in British Columbia can have significant impacts on trade, investment and business growth. A basic feature of the BC economy is that our export basket is heavily weighted toward resource-based goods – in most years, primary and processed resource goods together comprise 75-80% of the province's total international merchandise exports (see Table 1).[6] Moreover, most of BC's export-focused and import-competing industries operate essentially as price takers in the markets they serve. The outsized role of resource extraction and resource-related manufacturing in BC's export basket distinguishes the province from most other jurisdictions that have been early movers on carbon pricing. Unfortunately, this important point was overlooked as the government rushed to flesh out its far-reaching climate change plan over 2007-09.

Table 1
BC Merchandise Exports by Broad Commodity Grouping, 2011
(as % of total exports, in current dollars)

Coal	21.8
Pulp/paper	13.1
Lumber	11.7
Metallic minerals	10.7
Machinery/equipment	9.3
Natural gas*	5.9
Other wood products	5.7
Agricultural products	4.9
Other energy products	3.1
Fabricated metals	3.0
Fish products	2.7
Chemical products	2.7
All other products	5.4

* Note that prior to 2009, natural gas accounted for a substantially larger share of BC's exports. In the event that some of the planned LNG developments move forward, natural gas would quickly grow to represent 10-20% of the province's total international goods exports.

Source: BC Stats.

6 BC Stats, *Exports (BC Origin) 2002-2011,* August 2012.

For many BC industries, the carbon tax is an input cost that both makes it more expensive to produce goods and services here and raises the cost of shipping locally-produced goods to market. The government's commitment to "revenue-neutrality," whereby personal and business income taxes were reduced in tandem with the gradually escalating carbon tax, has ensured that the total tax burden hasn't increased since 2008. The Business Council supported this policy decision. At the margin, the revenue neutral design of the government's carbon tax program has been beneficial to industries that use little fossil fuel energy in their operations, and/or that are able to fully pass on higher energy-related costs to their customers, since the business tax cuts financed via the carbon tax have more than offset any increase in their energy and other operating costs.

However, revenue neutrality has done little to mitigate the adverse economic consequences of the carbon tax for BC industry sectors such as mining, pulp and paper, oil and gas, pipelines, transportation (both rail and trucking), agri-food, chemicals, cement[7], petroleum refining, and other energy-intensive manufacturing and commercial industries. For firms in these sectors, the business tax reductions linked to the carbon tax have been outweighed by the higher domestic energy, production and transportation costs attributable to the tax.[8] The problem is made worse because for most of these industries, their competitors located outside of BC don't pay carbon tax on their manufacturing, goods transportation, or other production activities.

Under a policy of a steadily rising carbon tax, more industries in British Columbia are destined to see negative economic impacts over time. And the competitive challenges for BC producers can be aggravated by other trends in the marketplace – e.g., softening external demand, expansion of foreign supply, a strong Canadian dollar, rising BC

[7] The Business Council notes strong evidence of a loss of domestic (BC-produced) cement sales to offshore producers that are not subject to any carbon tax. Similar substitution effects have also been observed in the domestic petroleum refining sector.
[8] In addition, firms with low or no reported profits are unable to benefit from business income tax reductions financed via the carbon tax.

electricity prices, high fuel taxes generally[9], or lower commodity selling prices (as currently seen in the natural gas industry). With the carbon tax climbing to $30/tonne GHG on July 1, 2012, with the antiquated Provincial Sales Tax slated to replace the HST next spring, and with no further provincial tax reductions or other measures to improve the domestic business environment on the horizon, EITEIs in British Columbia are increasingly being put at an economic disadvantage. Moreover, a review of how other jurisdictions with carbon pricing regimes treat their EITEIs shows that BC remains an outlier, offering little/no protection to industries grappling with the economic ramifications of a legislated carbon price that is now among the highest in the world.

There are a number of options available to address the situation of EITEIs, and that have been applied in other jurisdictions.[10] These can involve providing free permits or allowances to EITEIs operating under cap and trade regimes, which are subsequently reduced over time in a manner designed to incent ongoing efforts to reduce carbon output. Other mechanisms to address the competitive challenges for domestic industry arising from carbon pricing include: industry exemptions (full and partial); common treatment provisions to tax imported products and level the playing field for domestic industries that compete with goods imported from jurisdictions that don't price carbon[11]; and direct financial assistance to vulnerable sectors.[12]

The Business Council shares the concerns expressed by British Columbia EITEIs with respect to the carbon tax and its current and future effects on the competiveness of their

[9] Including the carbon tax, BC imposes higher fuel taxes than most other provinces, with particularly big gaps having opened up vis-à-vis Alberta and Ontario. Metro Vancouver has among the highest fuel taxes of any urban region in North America.

[10] Peterson Institute for International Economics and World Resources Institute, *Levelling the Carbon Playing Field: International Competition and US Climate Policy Design*, 2008, chapter 2. Some mitigation options are only feasible with a cap and trade program, while others can be used under a carbon tax regime.

[11] This could be implemented by applying the carbon tax at the point of sale.

[12] Earlier this year the BC government provided direct financial assistance to the greenhouse industry, which has been hit hard by the carbon tax as applied to its use of natural gas. However, the assistance was temporary in nature, and it does not offer a durable solution to the economic dislocation experienced by BC greenhouse growers as a result of the carbon tax.

local operations.[13] In combination with the failure to transition to a cap and trade system, BC may experience further trade and investment erosion unless policies are established to better manage risks around carbon leakage, and to ameliorate the cost advantages now enjoyed by imported versus locally produced goods in the domestic market.

An additional point is relevant to this discussion. When BC products are displaced by or lose market share to outside products, there is likely to be a negative overall impact on global GHG emissions. Increased transportation distances and additional product handling can drive up net emissions when BC-produced goods are displaced by imports. Also, it's important to recognize that because BC's electricity system depends overwhelmingly on renewable power, the "carbon footprint" of industries operating here is often lower than that of competing industries based in other jurisdictions. So to the extent that, say, BC mines, pulp mills, refineries or manufacturers lose market share – domestically or internationally – to suppliers based elsewhere, the net result is likely to be an increase in overall GHG emissions. All of this underscores a fundamental principle of effective carbon management: carbon pricing systems should adequately and fairly treat energy-intensive/trade-exposed domestic sectors, and should not foster, even if inadvertently, higher net global GHG emissions. This is another area where BC's carbon pricing policy has fallen short.

Slowing transition to renewable energy

While the transition to renewable energy has little direct relationship to the carbon tax, there were/are underlying linkages to BC's broader climate change agenda, which sought to build/diversify BC's energy products/consumption more aggressively into renewable energy. This component of the climate change plan was predicated on what, in 2007, seemed like a clear(er) path in BC's north-south trade markets to favour the development of renewable energy. Economically, the intent was to look at this potential marketplace

[13] That said, it must be noted that the longer-term competitive impact of the carbon tax on BC industries will depend in part on the climate change and carbon management policies adopted by other jurisdictions over time.

transition as an opportunity to grow BC's exports of renewable electricity and clean technologies, while coordinating climate change policies in the WCI trade region accordingly.

Despite shifts in the California energy marketplace with the introduction of an aggressive Renewable Portfolio Standard (RPS), the goal of an expanding WCI market for BC renewables has not been realized.[14] There are several reasons for this. The economic downturn and weak recovery in the US has dampened electricity demand. More fundamentally, the combination of lucrative US incentives for renewable energy (primarily wind and solar) and the continental shale gas revolution has pushed any BC renewable energy export opportunities well into the future.

The significance of this change in the US renewable energy marketplace in terms of BC's carbon tax is an indirect but important one. Prior to 2008, key partners within our trading region had been moving forward with economic and environmental policies that appeared to fit conceptually with BC's climate change plans, at least in theory. However, in practice the ground has shifted. In the absence of a broader move to carbon pricing within the WCI and elsewhere in North America, and given very limited external markets for BC renewables, the carbon tax has become increasingly disconnected from earlier policy goals that sought to link BC's economic and environmental objectives.

The Shale-Gas Revolution

Energy markets have periodically been punctuated by technological breakthroughs and major resource discoveries that influence energy prices and supply/demand dynamics. Much has been written in recent years about the technology-driven shale-gas (and to a lesser extent shale oil) revolution in North America. These massive new energy plays have, in a short period of time, re-written the energy supply and demand playbook and

[14] In terms of electricity trade into California, the market opportunity has been significantly reduced. Electricity export figures available from BC Stats show clearly the decline of electricity exports to the US. (http://www.bcstats.gov.bc.ca/statisticsbysubject/ExportsImports/Data/ElectricityTrade.aspx)

structurally lowered the trajectory of North American natural gas prices into the future. The low price environment for natural gas has been difficult for BC producers -- the province is geographically distant from major North American population centres and end-user markets; and the carbon tax has added further costs for the industry.

In this context, BC's own huge shale gas resources need to be factored into the government's policy and planning for energy development as well as for the environment. Under even the most conservative BC shale gas development scenario, the province will be extremely hard-pressed to meet currently legislated GHG reduction targets.[15] In the meantime, BC's previous competitive advantages as a continental natural gas supplier have evaporated. North America is awash in relatively low-cost shale gas, with cost-accessible supply predicted to outstrip demand far into the future – a development that is expected to keep downward pressure on prices.[16]

The Business Council is concerned that the BC carbon tax, now at $30/tonne GHG, may begin to impact investment decisions in the economically critical natural gas/LNG sector. Importantly, the tax has harmed the economic viability of the upstream natural exploration/production activity that is necessary to support the development of the nascent LNG industry. Indeed, it is worth noting that even if the main planned LNG plants are built in BC, total capital spending by the industry at the upstream end of the business is expected to substantially exceed the amount invested in LNG facilities.

While the natural gas outlook in 2007 may have provided margins that were sufficient to cover a relatively modest incremental domestic cost driver such as a carbon tax initially set at $10-15/tonne, this is no longer the case. As with other EITEIs, cost competitiveness

[15] The Business Council has reviewed the government's climate action plan targets against revised natural gas production scenarios, our own medium-term forecast for the provincial economy, and the other economic priorities highlighted in the BC Jobs Plan. Our conclusion is that a significant gap exists.
[16] See the Canadian Energy Research Institute's recent report: *Pacific Access, Part III: Economic Impacts of Exporting Horn River Natural Gas to Asia as LNG.* Available at: http://ceri.ca/

for the natural gas sector is a growing issue – one that needs to be evaluated as part of the province's energy development and climate change policy objectives.

In our view, it is no longer realistic to strive to achieve the 2007 GHG targets in today's economic environment -- and with the current suite of policies. Moreover, in a continental and global context, we believe a strong case can be made to accelerate the development/use of natural gas as a transition fuel: the goal should be to make faster progress in reducing coal-fired electricity generation in the global energy system, by taking advantage of the abundant supplies and relatively low costs of natural gas.[17] Opportunities to encourage fuel switching from oil products to natural gas are also possible in other sectors (such as transportation) and should be encouraged by public policy.

Within this economic framework, the government should carefully reconsider the carbon tax design to ensure the tax is aligned with the province's economic opportunities, particularly those identified as priorities in the BC Jobs Plan. This alignment is particularly important if BC is to successfully develop a promising new sector of our economy – LNG exports.

LNG Development

Nowhere is the contrast between the 2007 and 2012 policy environments sharper than in the case of LNG. In 2007 there were still plans across North America, including in BC, to import LNG in order to deal with prospective natural gas supply constraints that had contributed to a sharp rise in prices for the commodity. By 2011, when the BC Jobs Plan was announced, the natural gas sector had been turned on its head, as producing jurisdictions scrambled to diversify markets and find ways to move natural gas to more promising offshore markets as prices slumped in North America. Given the tremendous

[17] International Energy Agency, *World Energy Outlook 2012*, see the special section therein on "Golden Rules for a Golden Age of Gas." Available at: http://www.worldenergyoutlook.org

size of BC's shale gas reserves, coupled with low continental prices and the province's geographic location vis-à-vis Asia, the opportunity for this new export industry has led to growing interest in BC on the part of various LNG proponents.

The implications of the above developments for the carbon tax are significant. In terms of scale, the upstream and downstream production potential of LNG is unprecedented – it's conceivable that the size of BC's natural gas sector could more than double over a decade.[18] Realizing this opportunity would stimulate new economic and industrial development, create thousands of additional jobs, and generate substantial revenues for the province.

The carbon tax is also an important component of the economic model/policy design, and ultimately of the investment choices, for the fuel supply options needed to power proposed LNG facilities. Given the difference in the GHG implications between fuel supply options – direct drive natural gas versus a range of electrification options – the Business Council supports a comprehensive assessment of all options, one that includes consideration of carbon tax impacts. As LNG plants would likely fall in the category of EITEIs, this means ensuring that the carbon tax does not inadvertently distort investment decisions leading to suboptimal outcomes, and/or render otherwise attractive LNG-related projects uneconomic.

Finally, while the above analysis has highlighted the potential opportunities and issues associated with LNG development, a similar examination of growth opportunities and the evolving competitive dynamics of the marketplace can and should be undertaken for other industries. This subject will be taken up in the carbon tax review submissions to the Ministry of Finance from other industry organizations and companies in the energy, manufacturing, mining, forestry, trucking and railway industries.

[18] See *British Columbia's Natural Gas Strategy*, Ministry of Energy and Mines, 2012, p. 2, available at: http://www.gov.bc.ca/ener/popt/down/natural_gas_strategy.pdf.

Federal regulation of GHGs – the sectoral regulatory approach

The Canadian government is pursuing a regulation-based strategy to reduce GHG emissions, rather than one involving broad-based or transparent carbon pricing. Many of our members would prefer a federal approach to climate policy that makes greater use of national carbon pricing, but Ottawa has repeatedly stated that it will not go down this path. This is a reality that BC and other provinces must respond to.

A key premise of the current federal strategy is that Canadian regulations should be aligned with those developed in the United States. The bilateral Clean Energy Dialogue has provided focus for this policy intent and remains a central component of the strategy. Given the high degree of economic integration between the two countries, alignment with the US presumably would make compliance easier for cross-border firms and help to ensure that Canada's regulations do not put our own industries at an economic disadvantage on a North American basis.

To date, the federal government has completed regulatory reviews for four sectors: passenger cars, heavy-duty vehicles, renewable fuels and the electricity sector. The regulations for vehicles are largely composed of new emissions standards matching those of the US. Renewable-fuel regulations will ensure that, on average, gasoline contains a 5% renewable content. Regulations for the electricity sector prescribe new standards for coal-fired generating stations, which are designed to encourage a transition to cleaner electricity production.[19] Sector-focused regulatory efforts are now shifting to the oil-and-gas sector, with other large emitting industries (e.g., cement, aluminum, mining, pulp and paper) expected to follow soon. In addition to the sector-by-sector regulatory strategy, the federal government has committed roughly $150 million to a climate adaptation fund and established a Green Energy Fund that has supported projects across the country, including commitments to carbon capture and storage technology.

[19] http://www.ec.gc.ca/default.asp?lang=En&n=7852D1D2-1

Whether these policies will be sufficient to meet Canada's commitment to achieve a 17% reduction to 2005 GHG emission levels by 2020 remains a source of debate. At this point, there is no evidence that the Canadian government is prepared to contemplate any kind of broader carbon pricing regime. The result is that we now have two levels of government in Canada (plus multiple individual provinces) operating with different GHG targets, and utilizing different policy and regulatory instruments, as they attempt to achieve their various climate policy goals.

The Path Forward for Carbon Pricing – Policy Recommendations

As noted at the outset of this paper, most Business Council members support the concept of pricing GHG emissions as part of a longer-term strategy to move to a lower carbon economy. While the Business Council has expressed concerns about some aspects of BC's climate change plan since 2007, we have also recognized that the province wanted to define a leadership position on the policy challenges around climate change.

In more specific terms, the Business Council generally supports a number of carbon tax design criteria: the broad application of carbon pricing across the economy, periodic reviews of the tax in light of developments in other jurisdictions, and ensuring that any increases in the tax come in small, predictable increments. There are mixed views within our membership on whether to maintain the revenue-neutrality structure that has characterized the province's carbon tax regime since 2008.

Compared to the situation in 2007-08, BC today is in a different economic and policy environment – one that requires adjustments to the current suite of climate policies, including the carbon tax. The Business Council's overall support for pricing carbon does, conditionally, extend to the BC carbon tax. While a case could be made to dismantle the tax until a more comprehensive carbon pricing regime is in place in Canada or, preferably, North America, this cannot occur immediately. In the long-run, it seems reasonable to suppose that other jurisdictions will implement carbon pricing schemes of one sort or another – which suggests there may be merit retaining a carbon tax in British Columbia. In any case, eliminating the carbon tax would mean undoing the business and personal tax reductions instituted under the government's revenue neutrality policy, which could hurt the economy and/or create added fiscal difficulties for the province.

As discussed above, the Business Council believes the climate change policy framework established over the 2007-2010 period does need re-tooling – with the carbon tax review being a good first step. To this end, we offer the following recommendations.

Recommendation 1 – a comprehensive review of climate change programs

Initiate a comprehensive review of all elements of the government's climate change program, with the intent to align the suite of policy objectives more directly with the province's economic development opportunities and the priorities spelled out in the BC Jobs Plan. This review should include re-assessing the feasibility of the legislated GHG reduction targets adopted in 2007.

As part of the review, analysis should be undertaken of the economic and GHG impacts of different allocation options for carbon tax revenue. This would include looking at technology and offset funding undertaken to date through the Innovative Clean Energy fund, the Pacific Carbon Trust, and carbon neutral government initiatives, as well as at the experiences of Alberta and other jurisdictions that have established technology funds, offset programs, and other similar initiatives.

Recommendation 2 – freeze the carbon tax, maintain the tax base, and consider reducing the tax

At a minimum, the government should hold the carbon tax steady at the present level and reject any proposal for further increases. Indeed, at $30/tonne, BC's carbon price is already among the highest in the world. The government should also maintain the current base for the carbon tax – the Business Council is strongly opposed to extending the tax base to capture so-called “process emissions.” Based on the results of the Ministry of Finance’s review, the government should be prepared to reduce the carbon tax to below $30/tonne, once it has analyzed the input received from industry sectors and other stakeholders and carefully examined BC’s tax relative to the carbon pricing regimes in place in other jurisdictions.

Recommendation 3 – maintain revenue neutrality provision; develop clear policy for tax benefits

Most of our members support maintaining overall revenue neutrality, but there is some concern that many of the tax reductions funded via the carbon tax – notably those aimed at business – are not aligned with the goals and priorities of the Jobs Plan and have done little to enhance BC’s competitiveness. The currently wide range of business-related tax measures appears haphazard and disconnected from the original intent of revenue-neutrality.

Recommendation 4 – work toward a pan-Canadian approach to carbon pricing and climate policy

British Columbia should work with the New West Partnership, the Council of the Federation and the federal government to build a unified, Western Canadian and ultimately a pan-Canadian position on carbon pricing, allowing for industry-specific carbon regulation to occur as an interim step. In the long term, a continental carbon pricing regime, and/or a coordinated set of global carbon pricing initiatives, should be the objective. Looking ahead, British Columbia should pay more attention to the east-west dimensions of climate and energy policy and re-think its recent preoccupation with the California market.

Recommendation 5 – ensure BC’s carbon tax is factored into the federal sectoral regulatory approach

BC should immediately undertake discussions with the federal government and industry aimed at ensuring that future sector-by-sector GHG targets for oil and gas and other potentially impacted industries include carbon tax equivalency provisions and/or appropriate transitional mechanisms.

Recommendation 6 – review Alberta's GHG technology fund

The province should undertake a review of the outcomes from Alberta's technology fund, versus GHG abatement investments in BC in terms of the impact on emissions.

Recommendation 7 – EITEI policy in place for 2013/14 budget

Drawing on the experiences of other jurisdictions that have adopted carbon taxes or other forms of pricing, BC should establish a well-defined policy to ensure that EITEIs in the province are competing on a level playing field with competitors based elsewhere (both in export markets and in the domestic market). This includes establishing clear thresholds for impacted industries to gain access to relief from the carbon tax. The policy should be in place for the 2013/14 budget year.

Final Observations

The BC carbon tax was a worthwhile initiative introduced at a time when the province's future looked somewhat different than it does today. The Business Council applauds the Ministry of Finance for launching a review of the carbon tax, and we encourage the government to implement the recommendations discussed above in a timely fashion.

Ultimately, the Business Council favours a more thorough re-appraisal and updating of the entire BC climate change plan, one that goes beyond the carbon tax. Government faces a challenge in reconciling its economic and environmental objectives in a way that supports the province's position as a policy innovator and also respects and advances the priorities identified in the BC Jobs Plan. The Business Council is prepared to continue working with the province on these complex issues.

Finally, we would emphasize the need for government to look at the carbon tax as just one element in a dynamic mix of taxation and other policies that influence the overall business environment in British Columbia. In this regard, provincial policy-makers must be conscious of the fact that the province will soon be taking a major step away from having a competitive tax system for business when the HST is replaced by the former Provincial Sales Tax next spring. By itself, this is expected to increase sharply the effective tax burden on new capital investment in most industry sectors.[20] At the same time, many BC businesses are grappling with rising electricity prices, the high Canadian dollar, punitive local government property taxation, the "thickening" of the Canada-US border, and other competitive challenges. It is imperative that the government keep this broader economic picture in mind when considering the role and design of British Columbia's carbon tax.

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[20] According to a recent academic study, the average marginal effective tax rate on new capital investment in BC will climb from approximately 19% under the HST to more than 27% once the PST is re-established. See Duanje Chen and Jack Mintz, *2012 Tax Competitiveness Report,* School of Public Policy, University of Calgary, 2012.