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Eight Arguments against a Carbon Tax

What exactly is a carbon tax and how is the plan supposed to work?

The Liberals are proposing, if elected, to impose an immediate $10-a-tonne "carbon tax" on all so-called greenhouse gas (GHG) emissions. That tax would increase by $10-a-tonne each year until it reaches $40- a-tonne in four years. If implemented today, it would yield an estimated annual $15-billion by the year 2012.

According to the plan, the tax would not to be applied to gasoline on the grounds that the current federal gasoline tax already serves as a tax on carbon. It would, however, be applied to diesel fuel, but only after a one year delay (curiously, unlike gasoline, the Liberal plan does not consider the present federal tax on diesel to be the equivalent of a "carbon tax") and would be levied immediately on light and heavy fuel oil, jet fuel, natural gas, propane, and coal (Canadian bituminous and soft-bituminous).

The proposed carbon tax is to be offset by concurrent reductions in other taxes totalling between $9-billion to $10-billion and roughly $5-billion to $6-billion in increased federal transfers to lower-income Canadians, leading to the claim that it will be "revenue neutral". It should be noted, however, that this claim runs counter to proper accounting principles and is therefore somewhat dubious. Accordingly, the plan represents a net tax increase.

Eight arguments against the carbon tax

I make eight arguments against the Liberal carbon tax plan, in descending order of importance.

1. A carbon tax ignores the macroeconomic reality of a possible recession/stagflation.

Many experts are predicting that the crisis gripping the American financial sector will only worsen in the coming months, and may take as long as 4 years to fully turn around. Oil and natural gas prices will remain high and will begin to work their way into other sectors of the economy. So the United States risks a recession accompanied by an upturn in inflation.

Even if a carbon tax is a good idea, imposing such a tax at this time will have harmful consequences for Canada's economy. The Canadian economy, only marginally less dependent today on economic conditions in the United States than it has been in the past (76% of all Canadian exports in 2007 were destined for the US market), is already suffering the effects of the crisis south of the broader, particularly in the forestry sector (which is vulnerable to dips in the new housing market) and lately the car manufacturing sector. It is difficult to see how Canada's economy can avoid a similar fate if the US economy goes into a full-fledged recession. Most economists agree that new or increased excise taxes make recessions and periods of inflation worse by reducing income while driving prices up.

2. In a world of high energy prices, a carbon tax is not necessary for energy-use reduction.

Canada's total green house gas (GHG) emissions peaked at 741 megatonnes in 2003, and have since fallen 2.7 % to 721 megatonnes in 2006. Economists cite the free market and increased energy prices (and not Liberal environmental policy at the time) as the main reason for this decline.

Households and businesses alike have been hard hit by skyrocketing energy prices, and both have adjusted by lowering their energy use. In a world of high energy prices, there is no need for further taxes to induce conservation.

3. A domestic carbon tax in Canada will be inconsistent with emerging international efforts to reduce GHG emissions.

The current Conservative government favours adopting a “cap-and-trade" policy similar to those already implemented by the European Union and being considered by both candidates for president of the United States. A cap-and-trade program sets carbon limits for each major GHG producer. Any producer that exceeds the limit must go to the carbon market to purchase carbon-emission permits. This additional cost to producers acts as an incentive to reduce their carbon emissions.

The real problem, however, is not Canada, the US or the EU – it’s countries such as China, India, and other industrializing nations, that do not have any anti-carbon programmes in place at all and, so far, show little interest in adopting such programs. China in particular is commissioning an average of one dirty-coal-fired electricity plant a week and has already has passed the United States in total GHG emissions.

It is estimated by 2018 – when the carbon tax would have achieved its objective in Canada – the world will have increased GHG production by some 40 percent, from 30 billion to 42 billion tonnes, rendering the economic sacrifice that such a tax will impose on Canadians irrelevant to the global environment.

4. The plan lacks coherence.

In an attempt to portray a carbon tax as consumer friendly, the Liberal plan compromises its own rationale. The decision to not levy a direct carbon tax on gasoline, and to delay the tax on diesel fuel for one year, undermines the argument that such a tax is urgently needed in the first place. Proponents of the plan counter that the current federal gasoline tax (10 cents/L on unleaded; 11 cents/L on leaded gasoline) is, in effect, a carbon tax, but they ignore the fact that there is also a federal tax on diesel fuel. If the existing federal tax on regular and unleaded gasoline constitutes a "carbon tax", why isn't the federal tax on diesel fuel a "carbon tax" too? The answer is that the average voter does not use diesel fuel in their car, so the political fallout of imposing another federal tax on diesel has been calculated to be "acceptable".

In fact, there is no evidence that existing federal taxes on gasoline have the same effect as a carbon tax. Supporters of the carbon tax plan do not cite any statistics comparing the GHG-reducing effects of the existing tax and the proposed carbon tax – as to which is greater or less, today or four years from now. Does the existing federal tax fully account for carbon emission reductions?

Another problem with the "consumer friendly" face of the carbon tax plan – and this can be said of all corporate taxes – is the fact that, ultimately, businesses don't pay taxes – consumers do. All taxes "paid" by businesses are passed on to consumers as part of the price of the goods or services those consumers are purchasing – the more or higher the taxes, the higher the price of the product. Gasoline is not immune to this, so its price will rise with the imposition of a carbon tax despite claims to the contrary, since all intermediate-good processors of gasoline will pay carbon taxes on GHG-use at each stage.

5. The carbon tax will further disadvantage Canadian exporters (both manufacturing and non-manufacturing).

A carbon tax is a cost that all businesses will incur, either directly or indirectly. Higher production costs will reduce the competitiveness of Canadian products and services in international markets resulting in lost jobs.

Of course, it must be admitted that this effect is not limited to a carbon tax. Cap-and-trade comes with its own costs. But the negative impact of a carbon tax will be more serious because it will reduce competitiveness, not just relative to industrializing countries like

China, but to our other trading partners such as the US, who have adopted or will soon be in the process of adopting cap-and-trade.

Once again, it must be stressed that according to current estimates, countries like China will represent 85 percent of additional GHG emissions in the future. All Canadians will achieve through the economic sacrifices that would accrue with the imposition of a carbon tax, therefore, would be the transfer of more manufacturing jobs to China and other industrializing nations, with no solution to the GHG problem at hand.

In response, a few economists have proposed carbon tariffs to protect Canadian manufacturers and punish countries like China. Proponents of the carbon tax, along with others have hinted that they may consider implementing this option, but such tariffs would not help Canadian exporters. Indeed, they could very well hurt exporters further by inviting the imposition of retaliatory tariffs on goods manufactured in Canada. Such tariffs, moreover, could provoke a trade war, which could make the current economic downturn much worse. Recall that the Smoot-Hawley tariff (enacted in 1930) caused a trade war amongst developed nations. Most economic historians blame the US tariff for helping turn the 1929 economic downturn into a prolonged and severe depression.

6. The carbon tax will not be a substitute for cap-and-trade, but an addition to it.

As stated above, a cap-and-trade system will raise costs of production for Canadian businesses, since many will have to purchase carbon credits in the carbon market, for those operations exceeding government-mandated carbon emission limits. Adding a carbon tax greatly compounds this problem. Not only will Canadian manufacturers face comparatively higher costs of production, operating under both systems entail cumbersome compliance costs (on the part of businesses) and oversight costs (on the part of the federal government). Add to this various provincial carbon taxes (in British Columbia) and cap-and-trade systems (as in Ontario and Quebec), and Canadian businesses face a bureaucratic nightmare.

7. A carbon tax will discriminate against energy producing provinces, and rural areas.

Once a carbon tax is imposed, demand for energy-intensive products (like coal and oil) will fall. That's the whole idea. This will force a commensurate reduction in the production of such products, with provinces like Alberta, Saskatchewan and New Brunswick being hurt the most. (Recall the National Energy Plan!)

A carbon tax will harm rural areas too, but in a different way. Rural residents use relatively more gasoline and diesel fuel than residents in urban areas, and economic data shows that rural residents tend to have lower incomes, relative to their urban counterparts. Consequently the "tax neutrality" claim by the Liberals is false. Those living in urban areas will gain, while those living in rural areas will lose. This is already being seen in the tax revolt starting in British Columbia, given that province's new carbon tax. The tax revolt is centred in rural areas, and among truckers.

8. The carbon tax plan as proposed by the Liberal Party is really two plans in one: a tax on carbon consumption and a plan to make the federal personal income tax more progressive.

By itself, a carbon tax would be regressive since those with lower incomes spend relatively more of their incomes on carbon-intensive products. To counteract this, the Liberal Party is proposing a set of personal income tax revisions to help low income Canadians. For example, the Liberals propose to cancel the $1,000 Employment Income Tax deduction in favour of an additional income tax credit for those at the lower end of the income scale. By blending an anti-carbon strategy and an anti-poverty strategy, the Liberals are purposefully confusing the debate on the merits of the carbon tax. In effect, they are trying to sell a flawed carbon tax scheme by attaching to it an income redistribution scheme.

Ironically, the logic of a carbon tax is undermined by any plan to shift its cost onto higher-income people. Those with higher incomes are less likely to be induced by higher taxes to reduce their consumption, while those with lower incomes, who would be induced by higher taxes to reduce their consumption, are being sheltered from those higher taxes by either increased deductions or direct subsidies. That leaves middle-class Canadians alone to shoulder the burden.

Summary and Conclusions

The Liberal carbon tax proposal comes at the wrong time, with Canada facing a possible recession and increased inflation, nor is it needed, since Canada's GHG emissions are falling, and will fall further given skyrocketing energy prices. It will not appreciably reduce rising world GHG emissions, since China and other industrializing countries are increasing their emissions at a fast rate.

The proposal, if implemented. will be to harmful Canada's exporters particularly because it will be imposed as an addition to a cap-and-trade plan, rather than as a substitute, making the restrictions and associated costs that Canadian businesses will be forced to bear much more onerous than those in the EU/US cap-and-trade systems, which have no carbon tax.

The proposal will discriminate against western provinces and rural areas. It will also hurt middle- and upper-income Canadians.

All in all, I conclude that the Liberal plan makes for poor policy and should be rejected.

About the Author

David Murrell is a Senior Fellow at the Canadian Centre for Policy Studies and a professor in the Faculty of Arts, University of New Brunswick, in Fredericton, New Brunswick. He teaches economics, public finance, regional economics and public policy. He received his Honours B.A. and Masters of Arts from University of Ottawa in the early 1970s. After working as a Research Economist at the Conference Board of Canada for seven years, he earned a Doctorate in Economics at Queen's University, Ontario. He started teaching at Queen's in 1983, and at the University of New Brunswick in 1985.

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