

Carbon tax: an idea whose time has not come

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The latest catastrophe in public policy is the abject failure of the Liberal Project Green plan to curb greenhouse gases. Canada's emissions are now 25% above 1990 levels, certainly well above the promised 6% reduction by 2012. Costly policies such as voluntary controls, subsidy and tax giveaways and Rick Mercer one-tonne challenges have been ineffective, expensive ventures to overcome an initial ill-thought-out Kyoto target agreed upon in 1997 by prime minister Chretien.

That target, taken because it would reduce Canada's greenhouse gases marginally better than the United States, was chosen with little study as to whether Canada could accomplish the objective at a reasonable cost. Since 1997, the federal government has been stymied in trying to achieve the impossible.

One idea being thrashed about is a proposed levy on energy sources (oil, gas, coal and others), varying according to the product's carbon content. Long after being dismissed by the Chretien government, carbon taxation has recently reared its ugly head with Liberal leadership contender Michael Ignatieff proposing to implement it federally.

To further heighten interest, Quebec promised to levy a carbon tax as part of its Kyoto plan. Unfortunately, Quebec is being disingenuous with its public arguing that the tax will fall on oil and gas company profits rather than being passed on to consumers through higher prices for gasoline, heating fuel and other energy products. The provincial tax will need to be applied at the post-refining level, which makes it a consumer tax on products bought from suppliers at fixed international prices and impossible to shift back to producers.

So would a carbon tax be a good policy to deal with greenhouse gas emissions? Recent economic literature argues that carbon taxes can lead to a "double dividend" whereby emissions would be reduced (a green dividend) and the revenues could be recycled to cut harmful taxes to improve the efficiency in the tax system (a blue dividend). Actually, I like to think of environmental taxes as providing a third dividend, red, which is related to the distributional consequences of the policy. The case for the triple dividend argument, however, is not so clear. Here is why.

The argument for a carbon tax yielding a green dividend is that consumers will avoid purchasing

higher-taxed products with greater carbon content. However, the tax approach may achieve little in the way of environmental objectives. The demand for such products as gasoline and heating fuel is less sensitive to price, since the tax also falls on necessary, almost essential, services such as heating and transportation. The carbon tax is also a highly inflexible tool since it cannot be easily adjusted for changing emission levels. Further, governments become reliant on the revenue and are less willing to adjust the tax rates downward when emissions decline. For these reasons, some experts have argued that regulations that limit emissions, including tradable permit regimes, can be more effective and more flexible.

The "blue" dividend from a carbon tax could include recycled revenues spent on environmental programs. Dedicated taxes are anathema to finance departments since they introduce a rigidity in which the revenue must be spent on a bureaucratic-devised program regardless of whether the money is needed. Instead, greater bang for the buck could be achieved if carbon tax revenues were to replace economically harmful levies with high marginal tax rates on earnings, investment and risk-taking. You can bet your bottom tax dollar, however, that recycled revenues would likely be spent on transfers and politically driven public programs instead. Thus, no assurance can be given that the blue dividend would even be positive.

The carbon tax most likely results in a negative "red" dividend because it falls most heavily on the poor, whose consumption of gasoline, electricity and heating fuel tends to be a larger share of their resources compared with the rich. To get around this, some of the carbon tax revenues would be paid out as rebates to low-income Canadians to offset higher energy costs, thus negating the purpose of the policy.

So carbon taxes have little appeal in the sense that the "green" and "blue" dividends are far from certain and the "red" dividend is undoubtedly negative.

While current gas taxes are used to fund highways and roads or other infrastructure, proposals have often been made to raise the gas tax to curb greenhouse gas emissions and other pollutants. However, a broad-based environment tax on energy would be far better than a narrow-based environmental tax such as the gas tax. The case for turning the federal gas tax into a broad-based environmental tax on various forms of energy was

made by the Technical Committee on Business Taxation eight years ago. By keeping environmental revenues constant, the gas tax would be lowered in favour of new taxes on forms of energy reflecting environmental damage.

In the end, the carbon tax is an idea whose time has not come. If governments are to be serious about reducing greenhouse gases, they need to look for more effective policies surgically directed at emissions rather than using blunt instruments. Carbon taxes won't be much better than Project Green in achieving environmental or economic objectives.