

## **A Low-Carbon Economy, Priced to Compete? Yes.**

Christopher Ragan  
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In the run-up to the Paris climate meetings, several Canadian provinces are developing or improving their carbon-pricing policies. They should be applauded for using market-based approaches to reducing greenhouse-gas emissions. But businesses are nonetheless worried about how they will be affected, and this is too important an issue for governments to sweep under the carpet.

First, let's be clear about what business "competitiveness" really means. For any Canadian business, its ability to compete successfully against its domestic and foreign rivals depends on many things. Wages, regulations, corporate taxes, the quality of workers, access to efficient supply chains, proximity to markets, and foreign-exchange rates are just a few of the things that really matter.

A carbon price that firms must pay when emitting greenhouse-gas emissions adds one more element to this long list. But it only affects the competitiveness of a Canadian business if the carbon price at home is higher than the one its rivals face in other jurisdictions.

Governments must be mindful of this issue. The risk is that the carbon price at home may increase costs enough that some of our home businesses lose market share to their foreign rivals. In extreme circumstances, a domestic business may even close up shop and move its operations to a lower-carbon-price jurisdiction. In these cases, Canada would bear the costs associated with less economic activity but the effect on global GHG emissions would be nil; emissions would simply "leak" from one jurisdiction to another.

Yesterday, Canada's Ecofiscal Commission released a report examining the competitiveness effects from provincial carbon pricing, by looking at the data in different industries across several provinces. The report focuses on two important aspects of each industry – its "emissions intensity" and its "trade exposure".

An industry is emissions intensive if it generates a lot of greenhouse-gas emissions per dollar of GDP. And it is trade exposed if its businesses actively compete with firms outside the home province.

In principle, carbon pricing isn't really an issue for all firms and industries; it affects business competitiveness most in those industries with *both* high emissions intensity and high trade exposure.

The Canadian data show two interesting things. First, for the country as a whole, most industries face no significant competitiveness risk from carbon pricing. In fact, roughly 95 percent of Canadian GDP is produced in sectors that face little or no risk. This is mostly

because of the overwhelming importance of the service sector in a modern economy, a sector that produces few emissions and is often focused on local markets.

The second finding is that there are important differences across provinces. Industries such as cement, fertilizers, petrochemicals, and bitumen upgrading tend to be both emissions intensive and trade exposed, but they tend to be concentrated in specific provinces. The share of GDP exposed to competitiveness risks is higher than the 5-percent national average in both Alberta and Saskatchewan, but lower in British Columbia, Ontario, Quebec, and Atlantic Canada.

So, while the competitiveness risk is small for the economy as a whole, it is quite real in some sectors and some provinces. In those situations, governments need to ensure their policies are designed carefully to address these risks.

According to the Ecofiscal Commission, government policies should embody three principles.

First, governments should carefully examine the data, including micro-level data on the various firms within each industry, in order to accurately identify those situations with genuine competitiveness risks. It is not sufficient to simply accept the claims made by industry representatives.

Second, any measures that provide assistance to specific businesses or industries should be transparent, for all to see, and based on the data. Back-room deals that are not open to public scrutiny undermine the political acceptability of the entire carbon-pricing policy.

Third, any support measures should be temporary. They need to last long enough to provide useful assistance to the businesses involved, but not so long that those same businesses face no incentive to reduce their emissions.

The road back from Paris will be interesting, and complex. Carbon pricing in Canadian provinces will reduce greenhouse-gas emissions in a cost-effective manner. And though they are far smaller than many people think, some genuine risks to business competitiveness do exist. But a heads-up approach to policy design can strike the right balance, producing a low-carbon economy while maintaining a healthy and competitive business sector. This is exactly the balance we should be striving to achieve.

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