



2007 Federal Budget - Analysis of Environmental Measures

The 2007 federal budget¹ provided some groundbreaking measures to start harmonizing Canada's fiscal policy with environmental objectives, and some important funding for nature conservation. However, it was disappointing in its overall environmental impact because it did not include the funding and fiscal policies required to underpin an effective, comprehensive climate change strategy.

The budget document referenced a number of previously announced measures, whose funding was mostly taken from the 2006-07 fiscal year yet whose allocation depended on the passage of the 2007 budget. Table 1, below, details the specific funding and revenue implications of each measure for the fiscal years from 2006 - 2009.

Ecological Fiscal Reform

The 2007 federal budget made a number of important steps towards aligning Canada's fiscal policy with its environmental objectives, an approach often called ecological fiscal reform (EFR). The three most notable actions were the phase-out of the accelerated capital cost allowance (ACCA) for the oil sands, as part of a closer realignment of the ACCA with environmental values; the introduction of a modest carbon tax as part of a revenue-neutral "feebate" structure for new automobile purchases; and the acknowledgement of the importance of an emissions permit trading system to effectively addressing climate change.

These measures could take on an added importance if the government builds upon them in the coming months and years to institute comprehensive EFR and to thus make environmental values central to Canadian fiscal policy. Until now, the government's efforts in EFR have largely been limited to offering subsidies for desired activities, with little action on introducing fiscal disincentives such as fees, taxes and levies for environmentally damaging behaviour, or on reducing fiscal incentives for environmentally-damaging activities, which are often referred to as "perverse subsidies".

The 100% ACCA for the oil sands will be phased out by 2015 because, as the budget itself acknowledges, "this preferential treatment is no longer required."² Between 2011 and 2015, the preferential ACCA will be brought into line with the 25% level currently applicable to conventional oil and gas. This is the right signal and a step in the right direction. However, the

¹ See Department of Finance Canada (March 19, 2007): *The Budget Plan 2007 - Aspire: To a Stronger, Safer, Better Canada*.

² Department of Finance Canada (March 19, 2007): *The Budget Plan 2007 - Aspire: Creating Canadian Advantage in Global Capital Markets*, p. 408.

current 100% ACCA will remain in place until 2011 and project phases now³ under major construction will be fully exempted. This means that taxpayers will continue to provide unjustified subsidies for the vast majority of the approximately \$100 billion in new oil sands capital investments (announced projects) expected over the next decade. In fact, the pending phase-out may serve to accelerate investments in an already overheated sector.⁴

The ACCA was also expanded to support cleaner, more renewable sources of energy, and extended to continue applying to industries, including the oil sands, for investments in equipment that generates energy more efficiently or in the use of renewable energy. Class 43.1 and 43.2 of the *Income Tax Regulations*, which provide a 30% and 50%⁵ ACCA respectively for many renewable energy technologies, was expanded to include wave and tidal energy, as well as active solar heating, photovoltaics, stationary fuel cells, production of biogas from organic waste, and pulp and paper waste fuels. This is a welcome measure and should expedite the growth and development of such new technologies. The specific benefit varies, as activities eligible for Class 43.1 benefits would otherwise be subject to capital cost allowances ranging from 4% to 30%.

The Vehicle Efficiency Incentive (VEI) Structure uses a “feebate” structure that combines a modest carbon tax - a Green Levy of up to \$4,000 on new gas guzzling vehicles - with a rebate of up to \$2,000 for purchases of highly fuel-efficient vehicles and of “E85” flex fuel vehicles. The structure is intended to be roughly revenue-neutral, with the levy revenues exceeding the rebate cost.

This VEI is important because of its use of a fiscal disincentive and a revenue-neutral framework to influence behaviour. It is, however, a relatively poorly designed feebate. A large majority of those receiving rebates will likely be “free riders”, who would have purchased those vehicles regardless of the incentive, while the purchasers of the gas guzzlers may be so wealthy as to be unconcerned about the modest increase in cost. The benefit of including the E85 vehicles is highly questionable because while they can operate on fuel containing 85% ethanol, that fuel is not yet available to the public in Canada. Thus, for all practical purposes, these vehicles will pollute as much as any comparably sized vehicle not eligible for the rebate.

Acknowledging that older vehicles do emit a substantial portion of vehicle-related emissions, the budget allocated \$36 million for getting such vehicles off the road. Of this total, \$6 million will go to not-for-profit organisations that manage related initiatives, and \$30 million has been allocated for as-yet-unknown incentives “to be designed by Environment Canada and Transport Canada in consultation with stakeholders.”⁶

³ As of budget day, March 19, 2007.

⁴ The oil sands ACCA is expected to reduce annual federal government revenue by an average of \$300 million over the next several years, according to a Finance Canada official.

⁵ Class 43.1 applies to assets acquired before February 23, 2005. Class 43.2 applies to assets acquired on or after February 23, 2005, though its criteria are higher in some cases than those of Class 43.1.

⁶ Department of Finance Canada (March 19, 2007): *The Budget Plan 2007 - Aspire: To a Stronger, Safer, Better Canada*, p. 70.

Significantly, the budget documents acknowledged that “emissions trading will be an important component of a market-driven approach to reducing GHG emissions and air pollutants.”⁷ This is noteworthy because an emissions targets-and-trading system is likely the most effective means of reducing the close to 50% of Canada’s greenhouse gas (GHG) emissions which come from heavy industry (including electricity generation), and the trading component will allow reductions to be made much more cost-effectively.

The 15.5% transit pass tax credit was also extended slightly to include electronic fare cards used for at least 32 trips and weekly passes used for four successive weeks, allowing more transit users to benefit.

It was disappointing that the ‘super flow-through shares program’, a temporary measure instituted in 2000 to subsidize mining exploration, was renewed once again, this time until March 31, 2008. Such exploration often causes substantial social and environmental damage, despite applicable federal and provincial regulations, and makes it difficult to establish new protected areas.

The capital gains tax on donations of securities to private foundations was eliminated, which could lead to increased support for organisations and projects with environmental and conservation objectives.

Nature

There were a number of funding allocations for nature conservation, some substantial and some small steps towards achieving much greater objectives. There was progress in protecting species at risk, in cleaning up the Great Lakes, and in creating protected areas on land and in our neighbouring oceans.

For the first time, the government has provided sufficient funds to permit the effective implementation of the *Species At Risk Act*, an additional \$55 million annually over two years. This is the exact annual allocation that the Green Budget Coalition had recommended, for a five-year duration. For maximum benefit, this funding should be directed towards developing and implementing effective recovery strategies that identify and delineate critical habitat.

Ten million dollars, over two years, was allocated to conserve boreal forest in the Northwest Territories, including the protection of sites such as Sahoyúé - §ehdacho National Historic Site on Great Bear Lake (for which the federal government announced long term funding on March 11, 2007), the Nahanni National Park expansion, the Ramparts wetlands (Ts’ude niline Tu’eyeta), the Horn Plateau (Edézhie), and a proposed national park on the East Arm of Great Slave Lake. This is an important step forward towards long-term funding and larger land protection commitments in the north.

Funds were set aside from the 2006-07 fiscal year for a \$225 million investment in private land conservation which will play an important role in protecting species at risk and restoring ecological connections between protected areas in southern Canada, as well as \$30 million to

⁷ Department of Finance Canada (March 19, 2007), p. 35.

complete a pioneering conservation management and economic development initiative in British Columbia's Great Bear Rainforest.

A National Water Strategy should facilitate some initial progress towards cleaning up the Great Lakes, Lake Simcoe, and the Lake Winnipeg Basin as well as towards improving the health of our neighbouring oceans and their fisheries. It provided \$93 million to those areas as well as \$324 million to the Canadian Coast Guard for six new boats.

For marine conservation, the commitment to establish nine new marine protected areas is a step forward, but the \$19 million committed over two years is not nearly enough to achieve this commitment, let alone the overall sustainable development, management, and protection of ocean resources outlined in the budget document.

In addition, \$22 million was given to Environment Canada to hire 100 more enforcement officers, and \$30 million to the National Capital Commission for capital and operating funding.

Funding for Climate Change Programs

The 2007 budget included funding for renewable fuel production, and for transfers to the provinces and municipalities that should assist in reducing GHG emissions. However, the structure of these respective funding allocations is such that the resulting GHG reduction benefits are highly uncertain.

The 2007 budget did not provide the "massive scale-up of effort" which the former Commissioner on Environment and Sustainable Development emphasized⁸ was necessary to address climate change, the most fundamental environmental challenge facing our planet. Nor did it mention the May 2006 budget promise of a "made-in-Canada climate change program currently being developed by the Minister of the Environment," or the \$2 billion allocated for it from previous climate change programs⁹.

Furthermore, while the federal government has announced billions of dollars in climate change-related funding since the summer of 2006, including this 2007 budget, these combined funds have largely served to reverse cuts made in the first half of 2006 and have not yet brought Canada back to the funding levels in place at the end of 2005, even after fifteen months and a significant loss of momentum.

Five hundred million dollars is being made available to Sustainable Development Technology Canada to assist private companies in producing "next-generation" renewable fuels made using agricultural and wood waste products. Although this initiative will not reduce greenhouse gas emissions in the short-term, it could serve to stimulate substantial future GHG reductions.

Up to \$1.5 billion, over seven years, will finance an operating incentive for producers of renewable alternatives to gasoline (up to \$0.10/L), such as ethanol, and to diesel (up to \$0.20/L),

⁸ Johanne G elinas, former Commissioner on Environment and Sustainable Development: In her 2006 Report, and in her October 5, 2006, presentation to the Standing Committee on Natural Resources.

⁹ Department of Finance Canada (2006): *The Budget Speech 2006: Focusing on Priorities*, p. 12.

such as biodiesel, to replace excise tax exemptions for ethanol (\$0.10/L) and biodiesel (\$0.04/L) that will be eliminated on April 1, 2008. The initial rates will be in effect for three years and then be reduced. Support levels will also be limited in order to prevent these subsidies from supporting excess profits for the recipient companies.

This policy shift is not expected to produce any new reductions in GHG emissions, though it should assure the creation of a domestic ethanol production industry. Related emission reductions will be driven by previously announced federal regulations requiring 5% renewable content in gasoline by 2010 and 2% renewable content in diesel and home heating fuel by no later than 2012.

The Gas Tax Fund transfer to municipalities, for municipal priorities such as roads, transit and water, was extended four additional years, at \$2 billion/year, from 2010-11 to 2013-14. The budget also included \$1.5 billion from the 2006-07 fiscal year for the EcoTrust for Clean Air and Climate Change, which will provide funding to the provinces for major projects to reduce emissions of greenhouse gases and other air pollutants.

In both cases, the programs are worthwhile, but would likely provide much greater environmental and human health benefits to Canadians if the funding was made conditional on achieving specific environmental results, such as GHG emission reductions, and on implementing EFR measures, such as increased resource royalties and fees for energy consumption and road use. At present, the gas tax transfers could lead to reduced air pollution and improved health if spent on transit and water systems, but equally lead to deteriorating health, more pollution and new urban sprawl if spent on new roads and bridges.

Human Health & Protection from Toxic Substances

The budget mentioned the Chemicals Management Plan, announced in December 2006, which was funded by the 2006 budget with \$300 million for Environment Canada and Health Canada to help protect Canadians and the environment from toxic substances by better implementing the *Canadian Environmental Protection Act*.

The National Water Strategy further commits to creating new standards to ensure that all First Nations residents have access to safe drinking water, and to work with the provinces on improved regulations and controls to reduce the health risks caused by municipal wastewater effluents. Support for infrastructure investments could come from the gas tax transfers.

Table 1 is below.

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Table 1. Environmental measures in 2007 Budget¹⁰ (in million of dollars)

	2006-07	2007-08	2008-09	Total 2006-09	Details on full financial commitment
Energy & Transportation					
EcoTrust - Climate Change/Clean Air	1519			1519	For 2007-10
Expansion of ACCA to renewables		10	10	20	
Oil sands ACCA phase-out					Revenue implications uncertain
<i>Vehicle Efficiency Initiative</i>					
Rebate for fuel-efficient vehicles		80	80	160	
Green Levy on fuel-inefficient vehicles ¹¹		-110	-105	-215	
Scrappage of older vehicles		13	23	36	
<i>Subtotal - VEI</i>		-17	-2	-19	
<i>Renewable fuels</i>					
Operating incentive			120	120	\$1.480b / 2008-2015
Sustainable Development Technology Canada		200	25	225	\$500m
Eliminating excise tax exemption for ethanol and biodiesel ¹²			-40	-40	
<i>Subtotal - Renewables</i>		200	105	305	
<i>Subtotal—Energy & Transportation</i>	1519	193	113	1825	
Nature Conservation					
<i>Land-related</i>					
Nature Conservancy of Canada - conserving private lands	225			225	
Great Bear Rainforest	30			30	
NWT protected areas		5	5	10	
Environmental enforcement officers		7	15	22	
Species at Risk Act		55	55	110	
<i>Subtotal - Land-related</i>	255	67	75	397	
<i>National Water Strategy</i>					
Great Lakes clean-up		2	9	11	
International Joint Commission		2	3	5	
Lake Simcoe		6	6	12	
Lake Winnipeg		3	4	7	
Keeping our oceans clean		8	11	19	
Fisheries science research		17	22	39	
<i>Subtotal-Water Strategy</i>		38	55	93	
Coast Guard - 6 large vessels					\$324m over 10 yrs
<i>Subtotal—Nature Conservation</i>	255	104	130	489	
Total of Environmental Measures	1774	297	243	2314	
<i>Other</i>					
Gas Tax Transfers					\$8b=\$2b/y 2010-14
No capital gains tax on donations of securities to private foundations		75	75	150	
National Capital Commission		5	6	11	\$30m total

¹⁰ Based largely on Department of Finance Canada (March 19, 2007), p. 100-101, Table 3.7: “A Better Canada”.

¹¹ Net of removing excise tax on heavy vehicles.

¹² Based on 2006 use of renewable fuels in Canada.