Fueling Unfairness:

Carbon Pricing and Small Businesses

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Carbon Pricing and Small Businesses

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Background

In December 2019, Canada introduced the Pan-Canadian Framework on Clean Growth and Climate Change to meet its commitment under the Paris Climate Accord along with 194 other countries with the goal of ensuring that global average temperatures do not increase by 2°C in this century. Under the framework, the government has put a heavy focus on emission reduction through a variety of means including putting a price on carbon. The commitment to put a price on carbon emissions has led to the development of carbon pricing systems across the country and is the focus of this report.

In order to achieve the goals set out by the Pan-Canadian Framework, the federal government introduced a set of carbon pricing principles and criteria to which all provinces and territories had to adhere.[1] Failing to submit an approved carbon pricing system would automatically put those jurisdictions under the federal carbon pricing system, commonly known as the “federal backstop.”

The federal carbon pricing system is separated into two streams: first, a fee on fuels such as gasoline and natural gas, referred to as the “fuel charge” and commonly known as the “carbon tax.”[2] The carbon tax impacts consumers and small and medium-sized enterprises (SMEs) alike. The second stream is a performance-based system for large emitters, known as the Output-Based Pricing System (OBPS).[3] This report focuses on the fuel charge portion of the federal carbon pricing system.

The federal carbon tax currently impacts businesses and individuals in Ontario, Manitoba, Yukon, Alberta, Saskatchewan, and Nunavut, while all other provinces and territories are subject to their own jurisdiction’s federally-approved carbon pricing scheme (e.g., provincial carbon tax or cap-and-trade system) that must be equivalent to the federal pricing system on carbon.[4] However, as of July 1st,

[1] Government of Canada. (2020). Greenhouse Gas Pollution Pricing Act: Annual report for 2020.
[2] Government of Canada. (2022). Carbon pollution pricing systems across Canada.
[3] Government of Canada. (2022). Carbon pollution pricing systems across Canada.
[4] Government of Canada. (2022). Carbon pollution pricing systems across Canada.

2023, the list of provinces under the federal carbon pricing scheme will grow to include Nova Scotia, New Brunswick, Prince Edward Island, and Newfoundland and Labrador; leaving only British Columbia, Quebec, and the Northwest Territories with their own federally approved provincial carbon pricing system that results in a similar price on carbon as the federal system.[5]

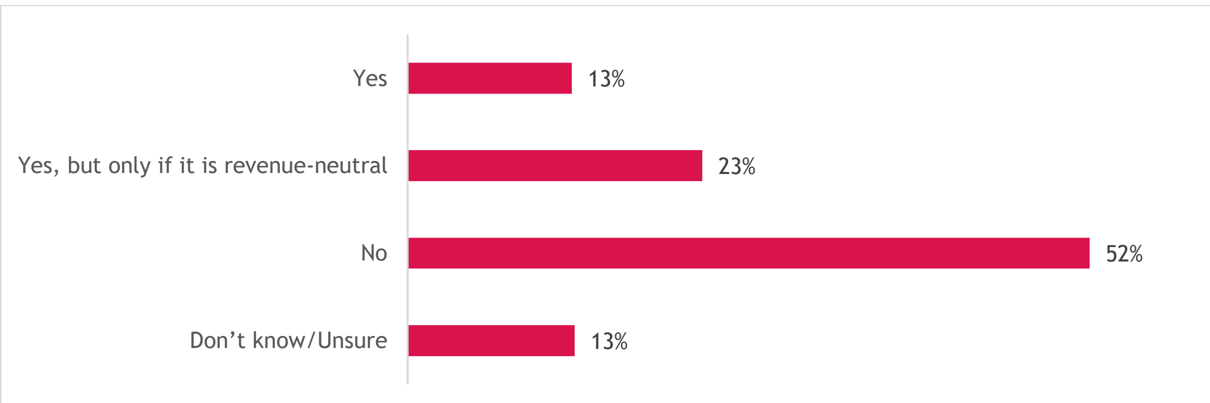
Much of the data used in this report is derived from CFIB's 2022 Environment Survey and official sources including the federal government, the Parliamentary Budget Officer, and the Bank of Canada. It is important to note that CFIB's survey asked carbon pricing questions to members across the country, not only those in federal carbon backstop jurisdictions.

Small business perspectives on federal carbon pricing

The majority of CFIB members do not support the current federal carbon tax. Members who do support carbon pricing in principle find the current carbon tax unfair. The data from figure 1 show that just over half (52%) of SMEs oppose carbon pricing, while only 13% support carbon pricing outright.[6]

Figure 1

Do you support carbon pricing (Select one)?



Source: CFIB. National Environment Survey 2022. August 15 - Sept. 20, 2022. Final results. CAN n=4,364.

The provincial breakout of the data showed that the prairie provinces (Alberta and Saskatchewan) have the highest levels of opposition to carbon pricing, while Quebec had the lowest levels of opposition (see Appendix figure 1.1). This difference in levels of opposition could be due to several factors, most notably the high proportion of SMEs in the energy and agriculture sectors throughout the prairies that are disproportionately impacted by the federal carbon pricing scheme. Similarly, in Ontario, which has a strong manufacturing industry, more than half of small businesses (52%) oppose a carbon tax.

Small businesses in Quebec may have the lowest levels of opposition due to the province's unique cap-and-trade system.[7] The cap-and-trade system is less visible than a carbon tax because it involves creating a market mechanism for allocating the right to emit a certain amount of carbon in the form of allowances. The price of these allowances is determined by supply and demand, rather than a

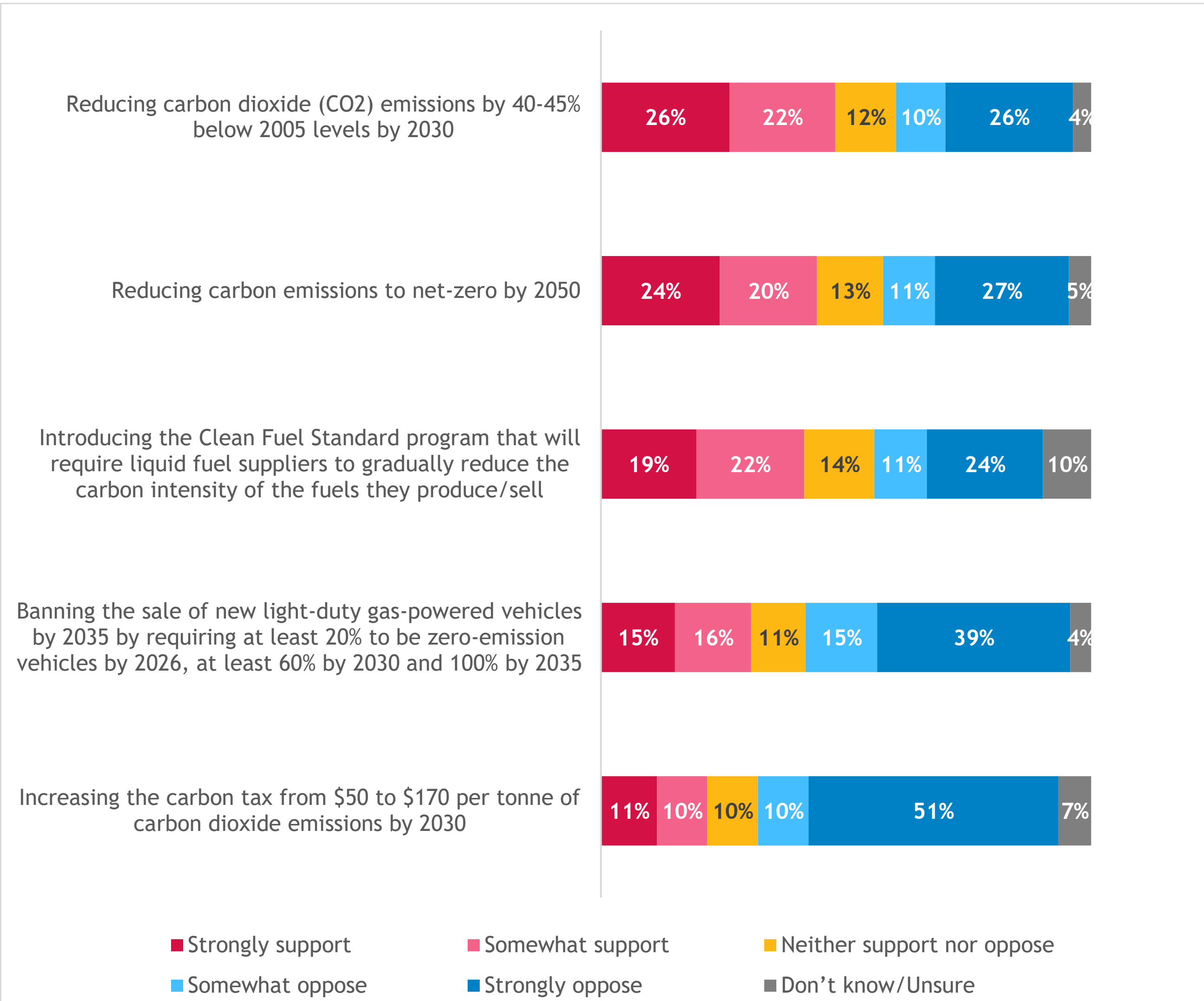
[5] Government of Canada. (2022). The Government of Canada strengthens pollution pricing across the country.
[6] CFIB. (2022). Environment Survey.
[7] Gouvernement du Québec. (2023). The Carbon Market, a Green Economy Growth Tool!

straightforward tax rate set by the government. The process of buying and selling allowances and the details of emissions limits set by the government make it much more difficult for SMEs and consumers to understand and track the costs of the policy. Therefore, there is little information on the pass-through cost of prices within the system that affects both SMEs and consumers.

Using data from CFIB's 2022 Environment Survey, Figure 2 shows varying levels of support for the federal government's various emission reduction initiatives.[8] Nearly half (48%) of SMEs support reducing carbon dioxide (CO_2) emissions by 40% to 45% below 2005 levels by 2030.

Figure 2

To what extent do you support or oppose the following federal government environmental initiatives? (Select one for each line)



Source: CFIB. National Environment Survey 2022. August 15 - Sept. 20, 2022. Final results. CAN n=4,364.

[8] CFIB. (2022). Environment Survey.

However, levels of support diminish when policies to reduce emissions include outright bans on products, as evidenced by the 54 per cent of SMEs who oppose banning the sale of new light-duty gas-powered vehicles by 2035. The highest level of opposition (61%) from small businesses is to increasing the carbon tax to $170/tonne of CO_2 by 2030, the centrepiece of the federal government's climate plan.

The facts and figures of the carbon tax

Since carbon pricing was first introduced in 2019, through the *Greenhouse Gas Pollution Pricing Act*, rates on select fuels have increased by $10/tonne annually from $20 to $50/tonne by April 1st, 2022. [9] These charges will eventually rise to $170/tonne by 2030, with $15/tonne increments starting in 2023 (Table 1).[10]

Table 1

Federal carbon tax increases ($/tonne)

Year	**2019**	**2019-20**	**2020-21**	**2021-22**	**2022-23**	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Carbon tax ($/ tonne)	20	30	40	50	**65**	80	95	110	125	140	155	170

Source: Government of Canada. (November 22, 2022). The federal carbon pollution pricing benchmark.

From 2019 to 2020, prices of gasoline and diesel increased significantly, due to a combination of tax increases and rising oil prices, causing transportation and operational costs to go up across every sector. With the carbon tax expected to rise an additional 23% to $65/tonne in 2023, SMEs and consumers will see a noticeable increase in the cost of gasoline and natural gas fuels. Gasoline and diesel-heavy sectors such as agriculture and construction may see significant cost increases that could dramatically impact their bottom lines.

According to Ministry of Finance estimates, between fiscal years 2019-2020 and 2022-2023, the federal government raised $22 billion in carbon pricing revenues and in 2022-2023 (with the carbon tax increasing to $65/tonne) approximately $8.2 billion is to be collected from the carbon tax alone, and this is before the addition of the maritime provinces to come July 1st.[11] However, despite the federal government raising a significant amount in carbon tax revenue, they have only returned $35 million to SMEs—significantly less than what they initially promised.[12]

[9] Government of Canada. (2022). The federal carbon pollution pricing benchmark.
[10] Government of Canada. (2022). The federal carbon pollution pricing benchmark.
[11] Government of Canada. (2022). Fall Economic Statement 2022.
[12] Government of Canada. (2022). Fall Economic Statement 2022.

How the carbon tax is unfair to SMEs

Survey data suggests that for Canadian small businesses, increases in the carbon tax coupled with minimal compensation are making the cost of doing business substantially higher, negatively impacting thousands of businesses. Three in five small businesses have seen their overall energy costs increase substantially (over 10%) in the last year while the majority (60%) have used the same amount of energy in previous years.[13] These results show that although the federal carbon tax is not an explicit line item on any bill, it does have a partial impact on raising the cost of doing business.

In addition, nearly a quarter (23%) of Canadian businesses support carbon pricing if it is revenue neutral (Figure 1). The federal government did promise that carbon pricing would be revenue neutral, however what was not said is that it *will not be revenue neutral for small businesses*. The federal government's carbon pricing system's revenue neutrality promise establishes that all revenues from the carbon tax are to be returned to the province in which they were raised. However, only a portion of 10% of the funds returned will be allocated to small businesses, and those funds are supposed to go directly to environmental retrofitting.[14] This revenue-neutral approach to carbon pricing is thus very different for small businesses than it is for consumers who receive back 90% of carbon pricing revenues to use as they please without having to fill out application forms.

Based on the government's latest Greenhouse Gas Pollution Pricing Act Annual Report to Parliament for 2022,[15] CFIB has calculated that only 0.17% of all carbon tax revenues collected between fiscal years 2019/2020 and 2022/2023 have been returned to SMEs. The unfairness of the carbon tax to small businesses has been further highlighted by Report 5 of the Commissioner of the Environment and Sustainable Development to the Parliament of Canada on Carbon Pricing released in 2022 to Environment and Climate Change Canada, which stated:[16]

> ***"In our view, due to the issues encountered in delivering the funding, the department had not addressed the burden from carbon pricing faced by small- and medium-sized enterprises."[17]***
>
> — The Commissioner of the Environment and Sustainable Development

Much of the unfairness comes from the fact that SMEs contribute significantly to federal carbon tax proceeds, yet do not receive the same level of rebates as individuals and households. The federal government initially allocated $218 million of carbon tax revenues over two years to help SMEs invest and install energy-efficient retrofits to be administered via the Climate Action Incentive Fund (CAIF).[18] However, barely any of the funding has been administered. In the 2019-2020 fiscal year, $0 had been given to SMEs to pursue environmental initiatives.[19]

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[13] CFIB. (2023). January Your Voice Survey.
[14] Rabson, M. (February 17, 2021). Canada owes $200M across 3 provinces after underestimating carbon tax revenue.
[15] Environment and Climate Change Canada. (2022). Greenhouse Gas Pollution Pricing Act: Annual Report to Parliament for 2020, p.13
[16] Office of the Auditor General of Canada. (2022). Reports of the Commissioner of the Environment and Sustainable Development to the Parliament of Canada: Carbon Pricing—Environment and Climate Change Canada.
[17] Office of the Auditor General of Canada. (2022). Reports of the Commissioner of the Environment and Sustainable Development to the Parliament of Canada: Carbon Pricing—Environment and Climate Change Canada, p.21.
[18] Office of the Auditor General of Canada. (2022). Reports of the Commissioner of the Environment and Sustainable Development to the Parliament of Canada: Carbon Pricing—Environment and Climate Change Canada.
[19] Office of the Auditor General of Canada. (2022). Reports of the Commissioner of the Environment and Sustainable Development to the Parliament of Canada: Carbon Pricing—Environment and Climate Change Canada.

CFIB has undertaken previous research on the federal carbon pricing program and has noted the unfairness that exists within the program between households and small businesses. Our best estimates have shown that small businesses pay almost 50% of the carbon tax while only 7% of the revenue was supposed to be returned to them. As noted earlier, only 0.17% has actually been returned to them in the form of programs. CFIB's estimate is the only one available since the government has never released numbers on how much it collects from small business. We would welcome any data from government that supports or contradicts our estimates.

A recent CFIB survey[20] found that 60% of small businesses could not pass the increase in energy costs to consumers, suggesting that most of them are absorbing, and will continue to absorb, the added cost of energy in their production processes. To date, no concrete changes to the program have been made to help small businesses mitigate the negative impact of the carbon tax.

Recently, the federal government announced the creation of the Fuel Charge Proceeds Return Program (FCPRP) with the goal of returning over $2.5 billion to SMEs, specifically those in emissions-intensive and trade-exposed (EITE) sectors, by March 2025. [21] This initial program design raises several concerns. First, the program runs the risk of repeating mistakes of the past by adding unnecessary costs and red tape. Second, there is little information on how the government will decide who is eligible, or if there will be an appeal process. Third, it is expected to take until 2025 to pay out all the funds that the government has accumulated since 2019, leaving small businesses waiting six years to see returns from the federal carbon tax.

According to the Department of Finance, SMEs in federal backstop jurisdictions should expect to receive nearly $1 billion in the 2023-24 year. It remains unclear whether SMEs will have to deal with lengthy program applications and stringent eligibility requirements, which may mean they will have to spend significant time and resources to apply for the rebates. While SMEs wait for the details of the new program, the reality is that the already high cost of doing business will rise with the carbon tax increasing to $65/tonne on April 1st, 2023.

The impact of a $170/tonne federal carbon tax on SMEs

A $170/tonne carbon tax could have a significant impact on the Canadian economy and small businesses, potentially leading to increased costs of doing business, lower business investment, and reduced competitiveness.

For instance, a 2022 report from the Parliamentary Budget Officer showed that a $170/tonne price on carbon will reduce real Gross Domestic Product (GDP) in Canada by 1.3% by 2030 as well as result in a 2.3% reduction in labour income and a 3.6% decline in investment income.[22] Other reports estimate a 1.8% reduction in GDP and a loss of almost 200,000 jobs nationally by 2030.[23]

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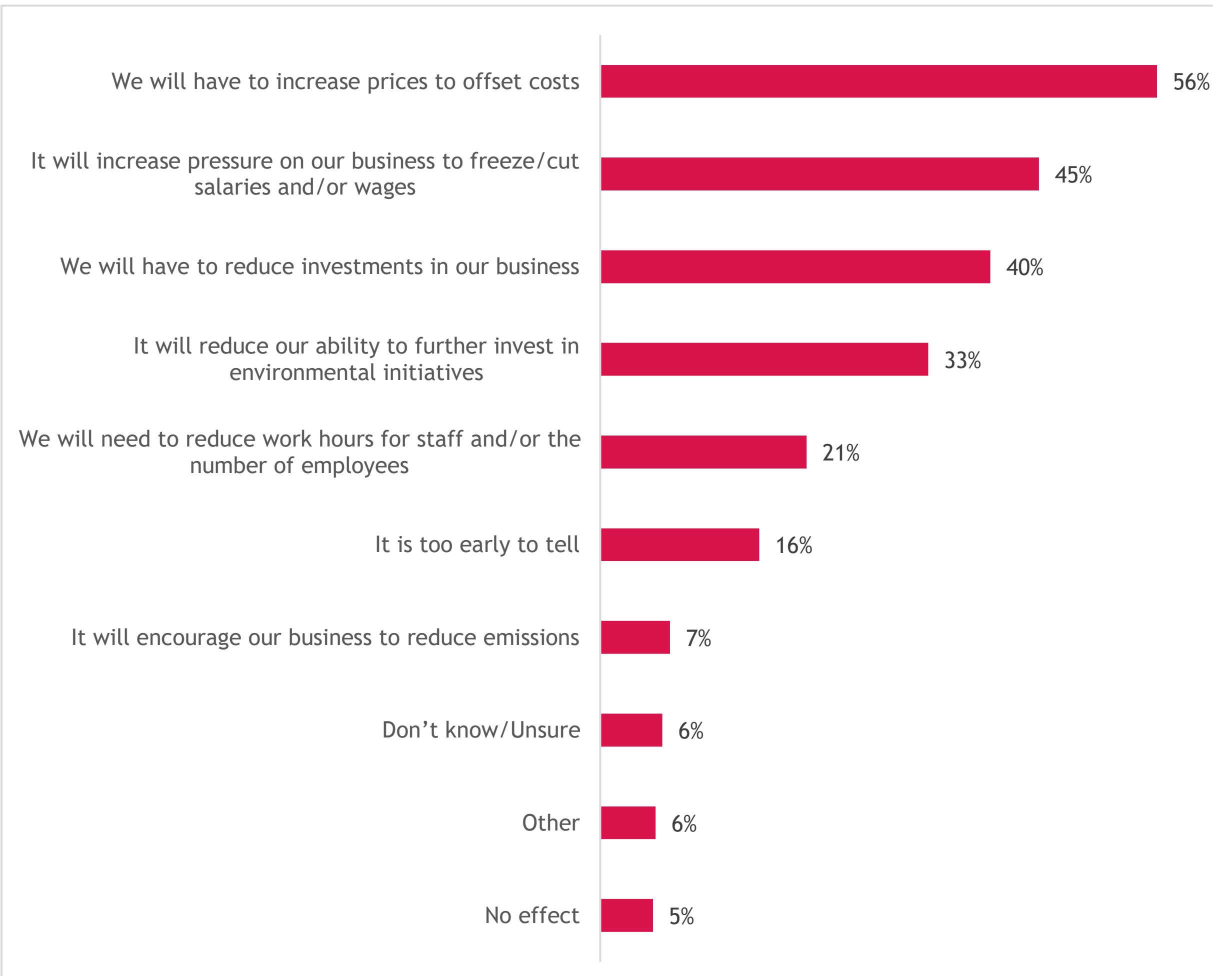
[20] CFIB. (2023). January Your Voice Survey.
[21] Department of Finance Canada. (2022). Government returning over $2.5 billion in fuel charge proceeds to small- and medium-sized businesses.
[22] Office of the Parliamentary Budget Officer. (2022). A Distributional Analysis of Federal Carbon Pricing under a Healthy Environment and a Healthy Economy.
[23] McKitrick, Ross, and Aliakbari, Elmira. (2021). Estimated impacts of a $170 carbon tax in Canada.

The goal of carbon pricing is to increase the price of fossil fuel energy sources such as gasoline, diesel, and natural gas. Given that most small businesses rely on these sources for heating, electricity, transportation and raw materials, a rising price on carbon will result in higher production and operation costs. Food, for example, is more sensitive to energy price increases than most goods because large amounts of energy are required to produce, transport, and heat/cool food.

In this context, Canadian small businesses will be particularly vulnerable to the impacts of a $170/tonne carbon tax, as they often have more limited resources—in contrast to large businesses— to absorb these additional costs. In fact, more than half (56%) of small businesses indicate they will have to increase prices to offset higher energy costs (Figure 3).[24]

Figure 3

How will the increase in the carbon tax from $50/tonne of CO2 emissions (11c/litre of gas) in 2022 to $170/tonne of CO2 emissions (38c/litre of gas) in 2030 affect your business? (Select all that apply)



Source: CFIB. National Environment Survey 2022. August 15 - Sept. 20, 2022. Final results. CAN n=4,364.

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[24] CFIB. (2022). Environment Survey.

CFIB expects these results to remain the same or worsen as the federal carbon tax continues to increase (and soon at an even faster rate). These cost increases will cause higher energy prices which will most likely result in higher prices for goods and services as evidenced by the data from our members (Figure 3).

Similarly, 40% of small businesses claim they will have to reduce investments in their business as a result of higher energy prices.[25] If firms decide to reduce business investment, while overall demand continues to grow, Canada might end up with an economy in which businesses will not be able to keep up with growing demand which will also lead to higher prices for most goods and services.

In addition, the rising price on carbon will increase the pressure on almost half of Canadian small businesses (45%) to freeze/cut salaries and wages.[26] Given that small businesses already operate on tight margins, it is likely they will have to make difficult choices to stay afloat. This could lead to job cuts and reduced benefits for employees, as well as potentially higher prices for consumers. Lastly, only 5% of Canadian small businesses report that increasing the carbon tax to $170/tonne will have no impact on their operations.[27]

Emissions-intensive and trade-exposed (EITE) industries like agriculture, natural resources, construction, wholesale, and manufacturing will be disproportionately affected by an increase of the federal carbon tax. Not coincidentally, the level of small business opposition to this policy is high among these sectors, with the highest level of small business opposition in agriculture (with 86% of small businesses opposing the policy) and the lowest level in manufacturing (with 63% of small businesses opposing the policy).[28]

In conclusion, a $170/tonne carbon tax will have a significant impact on the Canadian economy, particularly small businesses, leading to increased costs, higher prices for goods and services, lower business investment, and reduced competitiveness. As such, the federal government should rethink its carbon pricing policy to address the fundamental unfairness that currently exists for small businesses.

Ways to mitigate the impact of carbon pricing on small businesses

Small business owners understand the importance of environmental protection but perceive the current federal carbon pricing system as unfair. The federal carbon tax imposes a disproportionate burden on small businesses, with the majority of the revenue generated from it being allocated to household rebates. As a result, small businesses are left with the challenge of absorbing the added costs from their own resources, and for some, this could mean sacrificing wages or curtailing future investments in growth and productivity because they are unable to fully pass on the costs to consumers.

Additionally, government-imposed costs, such as the carbon tax, make it more difficult for SMEs to compete in highly competitive domestic markets and with businesses in jurisdictions with lower carbon prices and less stringent regulations because raising the prices of their goods and services (due to increased energy costs) could potentially result in a decline in market share. As a result, almost 70% of

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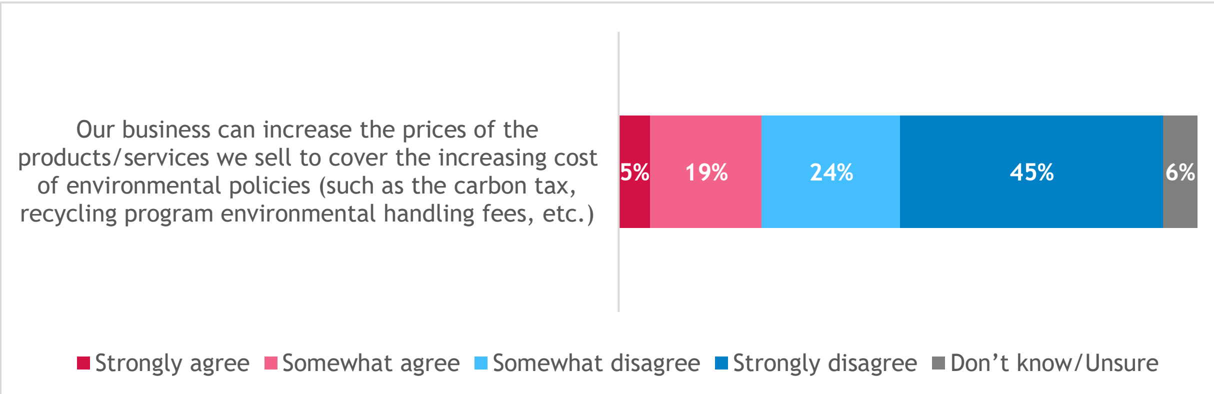
[25] CFIB. National Environment Survey 2022. August 15 - Sept. 20, 2022. Final results. CAN n=4,364.
[26] CFIB. National Environment Survey 2022. August 15 - Sept. 20, 2022. Final results. CAN n=4,364.
[27] CFIB. National Environment Survey 2022. August 15 - Sept. 20, 2022. Final results. CAN n=4,364.
[28] CFIB. National Environment Survey 2022. August 15 - Sept. 20, 2022. Final results. CAN n=4,364.

small businesses are not able to increase the prices of their products and services to cover the increasing cost of environmental policies (Figure 4).

Figure 4

Please indicate the extent to which you agree or disagree with the following statements:

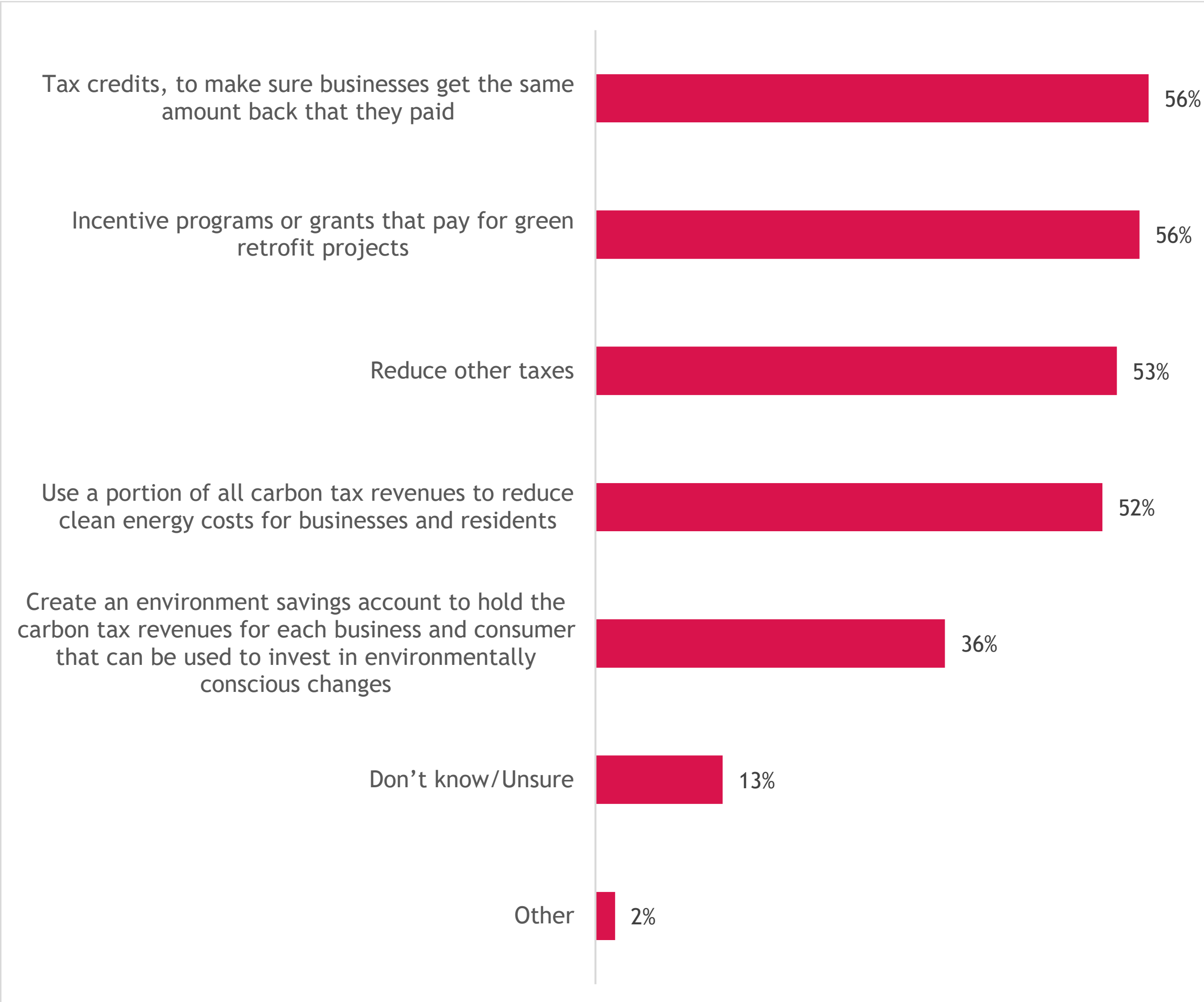


Source : CFIB. National Environment Survey 2022. August 15 – Sept. 20, 2022. Final results. CAN n=4,364.

There is a range of potential approaches governments can take to ensure that carbon pricing is fair and that generated revenues are returned to small businesses. These options, shown in Figure 5, have been identified through our member research and analysis of existing carbon pricing policies and their impact on small businesses. Most measures involve a combination of tax credits, incentives, and tax reductions intended to return carbon tax proceeds to SMEs in a proportionate amount relative to their contributions.

Figure 5

What approaches should governments take to make carbon pricing fair and return revenues to small businesses? (Select all that apply)



Source : CFIB. National Environment Survey 2022. August 15 – Sept. 20, 2022. Final results. CAN n=4,364.

There are a number of options governments can consider in making carbon pricing fairer to small businesses including the creation of tax credits, incentive programs or grants that pay for green retrofit programs and reducing the overall tax burden (such as payroll taxes, business taxes, etc.).

Conclusions and recommendations

Small and medium-sized businesses play a vital role in the Canadian economy, and it is essential that any carbon pricing policy considers their unique needs and challenges.

While a majority of small businesses (52%) are opposed to the federal carbon tax, there is a lot of variation by province just like there is with the general population. Much of this opposition is due to the high costs the current federal pricing system places on small business which is the result of the unfair way the federal carbon backstop was designed. We estimate that almost 50% of federal carbon taxes are being collected from small businesses but only about 7% was originally supposed to be returned to them in some form. In reality only 0.17% has so far been allocated to small firms. This report highlights the importance of addressing the current unfairness of the federal carbon tax on small businesses. To address this imbalance, we ask that government:

1. Freeze the federal carbon pricing backstop at the current level ($50/tonne).

2. Immediately return the $2.5B in federal carbon tax revenues it has collected from SMEs since 2019.

3. Rethink the federal carbon pricing formula moving forward to make it fairer for small businesses, ensuring they get back an amount that is similar to what they pay into it.

4. Consider eliminating the carbon tax and focus on other ways to effectively reduce greenhouse gas emissions.

5. If a carbon tax is maintained, lower other small business taxes to offset the costs of carbon pricing on their business.

6. Continuously evaluate and address any inefficiencies and negative impacts of the carbon pricing on SMEs and track the amount of carbon tax being paid by small businesses to ensure that an equivalent amount is being returned to them.

7. Further support small business in dealing with carbon costs by:
    a. Voting in favor of Bill C-234 that will add additional exemptions on carbon pricing for farmers as quickly as possible.
    b. Providing some special consideration for businesses that will be particularly hard hit by carbon pricing going forward, such as trucking, manufacturing, etc.
    c. Extending the federal Accelerated Capital Cost Allowance (ACCA) and make immediate expensing permanent to help businesses invest in new energy-efficient equipment and machinery.

Methodology

CFIB is a non-partisan organization exclusively representing the interests of 97,000 small- and-medium-sized businesses in Canada. CFIB is entirely funded by our members and takes direction from them through regular surveys on a variety of issues like environment and sustainability.

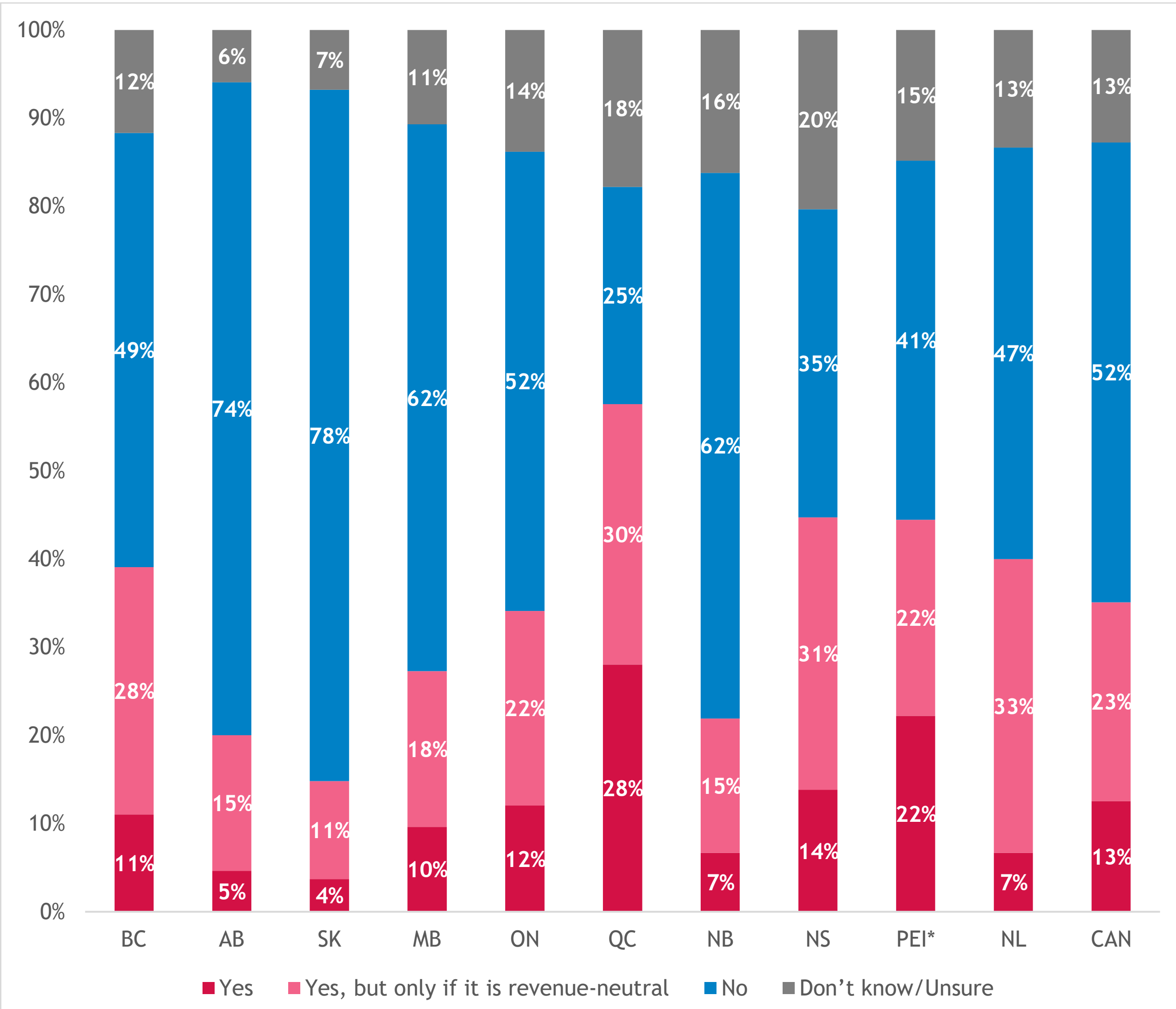
CFIB conducted the 2022 National Environment Survey from August 15 to September 20, 2022, across Canada. The password-protected online survey received 4,364 responses from small business owners across all sectors and provinces. The results are accurate to ± 1.5 percentage points, 19 times out of 20. Unless otherwise indicated, data in this report was obtained through the above survey.

Appendix

Provincial breakouts of Figure 1: Do you support carbon pricing? (Select one), and Figure 2: *To what extent do you support or oppose the following federal government environmental initiatives?* (Select one for each line)

Figure 1.1

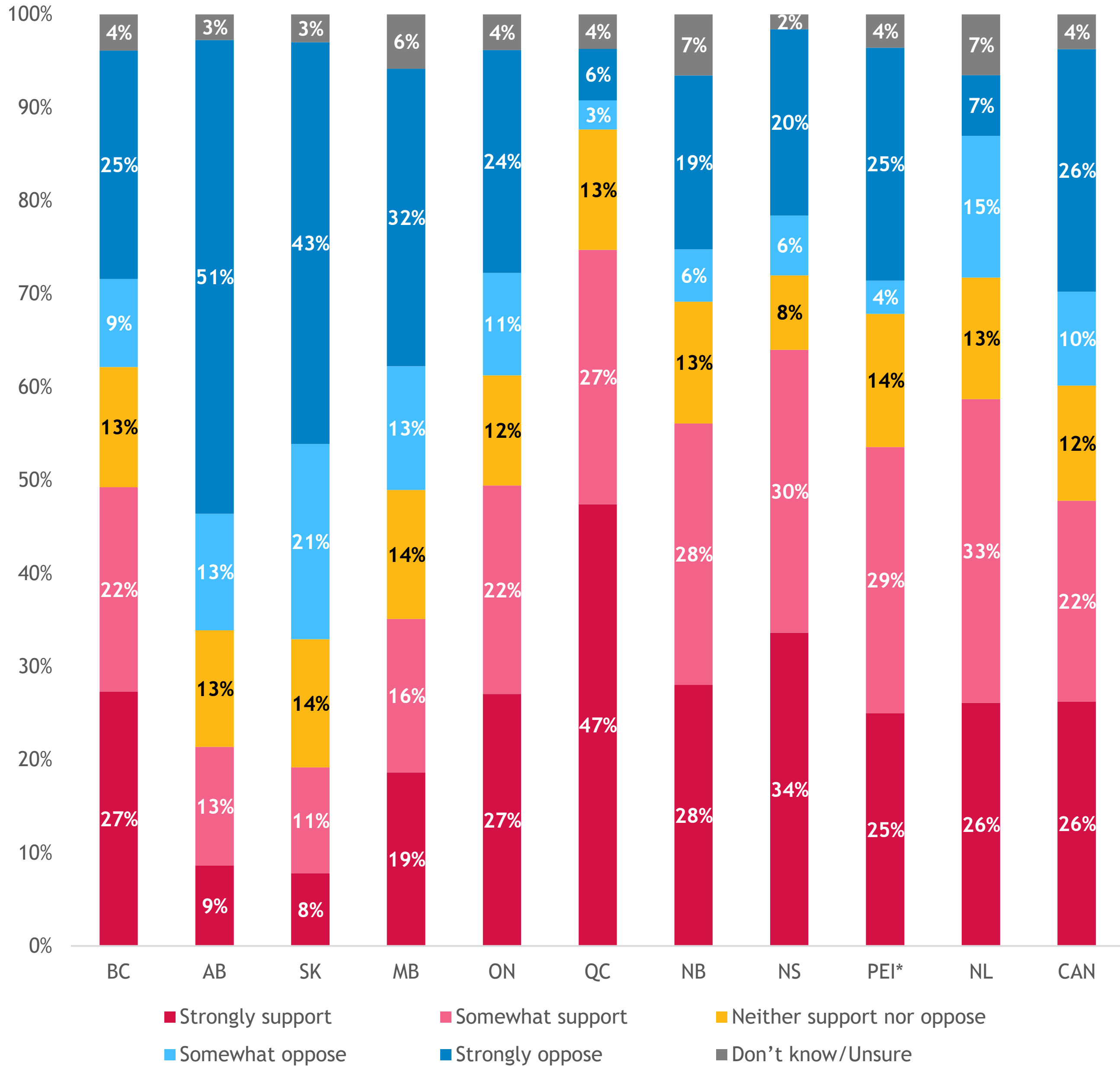
"Do you support carbon pricing? (Select one)"



Source: CFIB. National Environment Survey 2022. August 15 - September. 20, 2022. Final results. n= 4,364.
*Low response rate

Figure 2.1

"Reducing carbon dioxide (CO_2) emissions by 40-45% below 2005 levels by 2030"

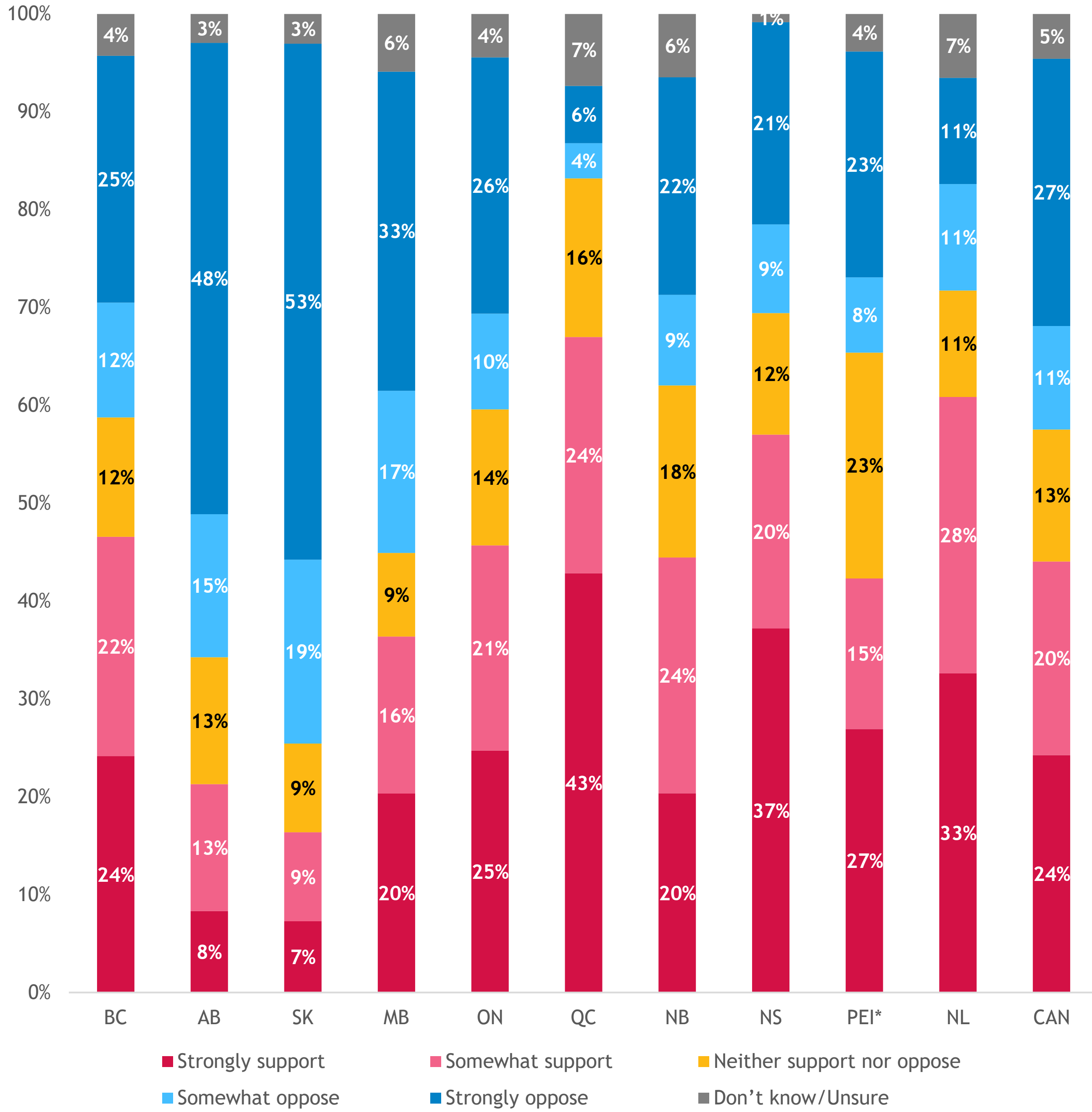


	BC	AB	SK	MB	ON	QC	NB	NS	PEI*	NL	CAN
Strongly support	27%	9%	8%	19%	27%	47%	28%	34%	25%	26%	26%
Somewhat support	22%	13%	11%	16%	22%	27%	28%	30%	29%	33%	22%
Neither support nor oppose	13%	13%	14%	14%	12%	13%	13%	8%	14%	13%	12%
Somewhat oppose	9%	13%	21%	13%	11%	3%	6%	6%	4%	15%	10%
Strongly oppose	25%	51%	43%	32%	24%	6%	19%	20%	25%	7%	26%
Don't know/Unsure	4%	3%	3%	6%	4%	4%	7%	2%	4%	7%	4%

Source: CFIB. National Environment Survey 2022. August 15 - September. 20, 2022. Final results. n= 4,364.
*Low response rate

Figure 2.2

“Reducing carbon emissions to net-zero by 2050”

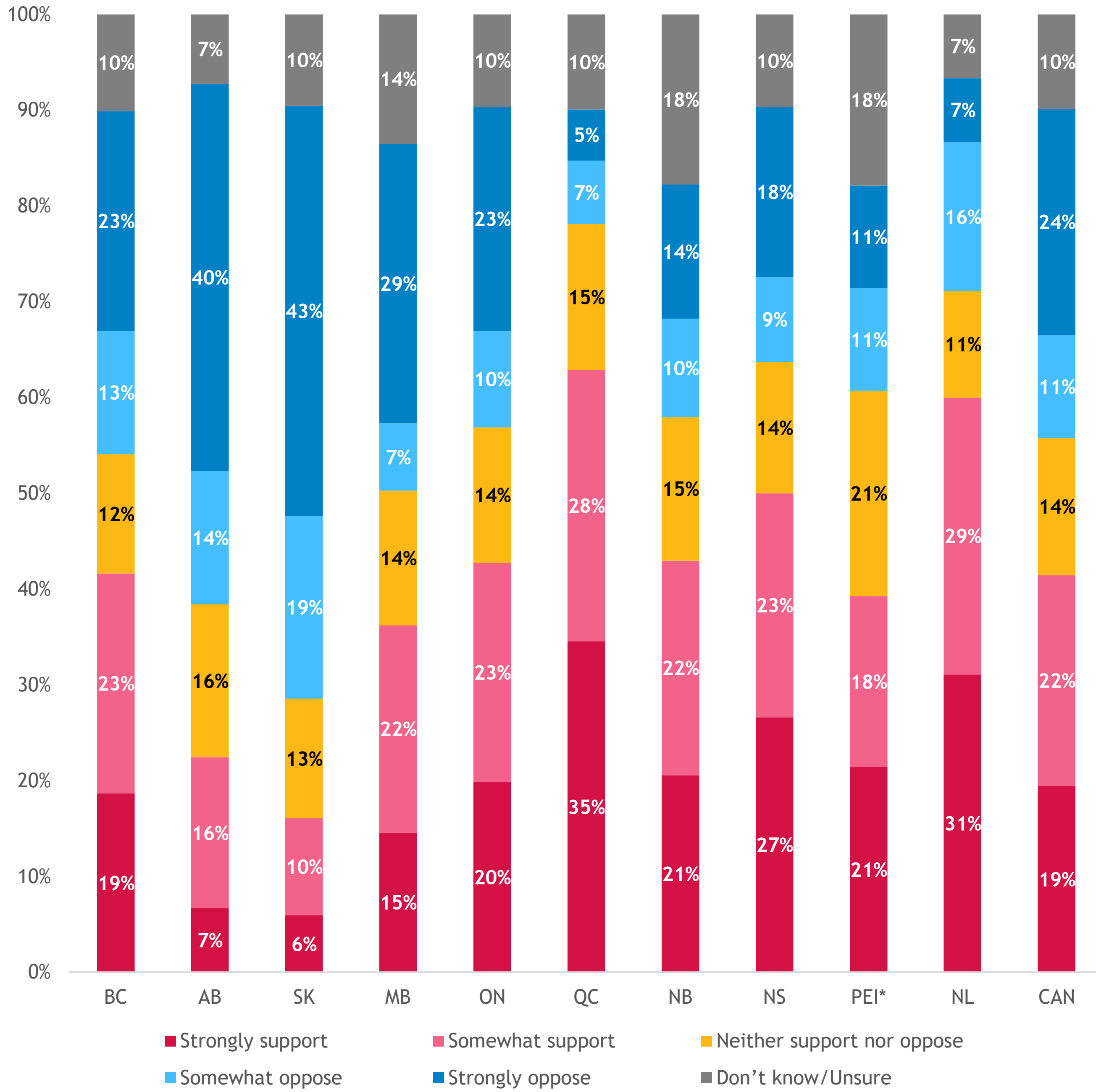


Source: CFIB. National Environment Survey 2022. August 15 - September. 20, 2022. Final results. n= 4,364.

*Low response rate

Figure 2.3

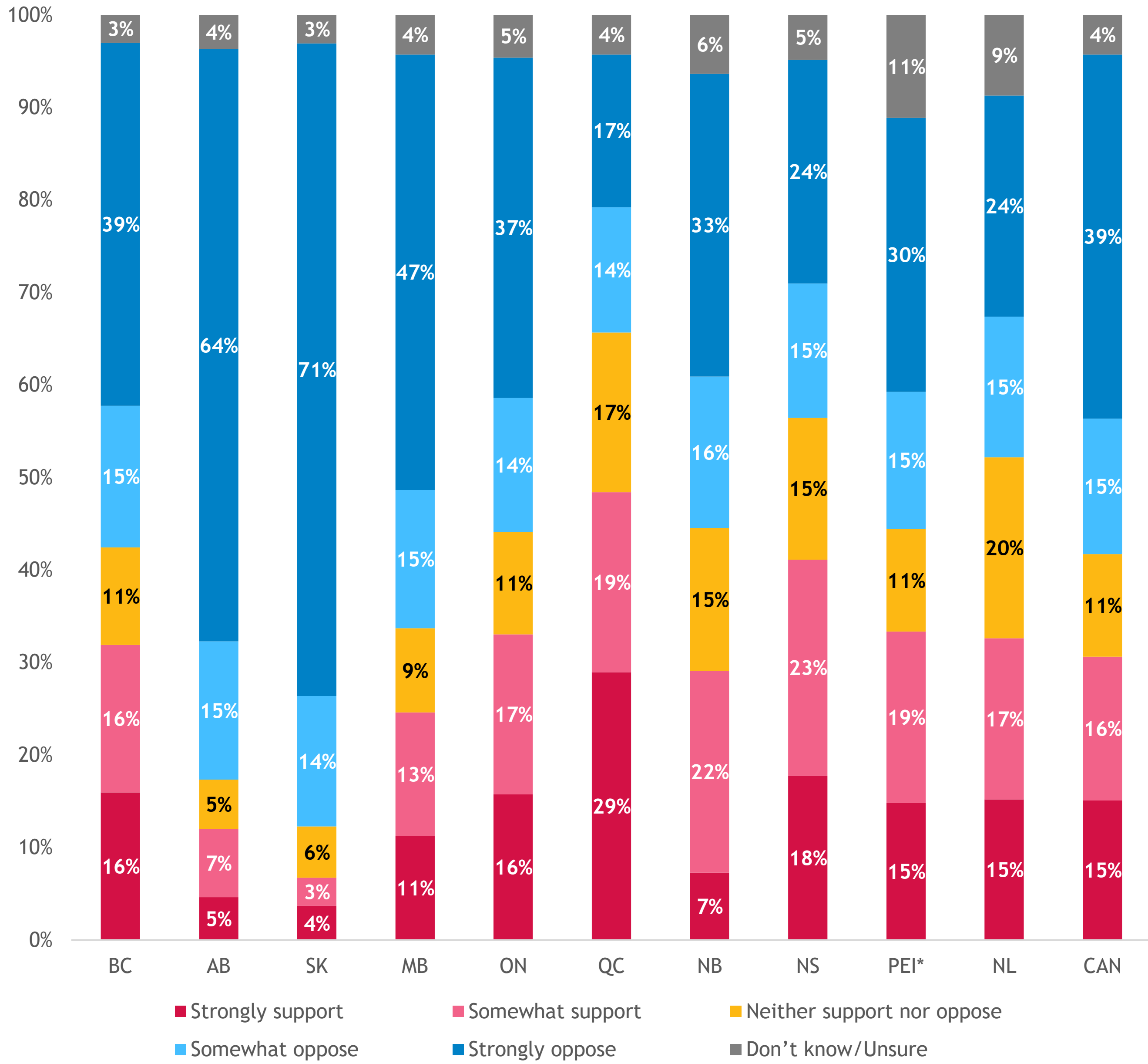
"Introducing the Clean Fuel Standard program that will require liquid fuel suppliers (gasoline and diesel) to gradually reduce the carbon intensity of the fuels they produce/sell"



Source: CFIB. National Environment Survey 2022. August 15 - September. 20, 2022. Final results. n= 4,364.
*Low response rate

Figure 2.4

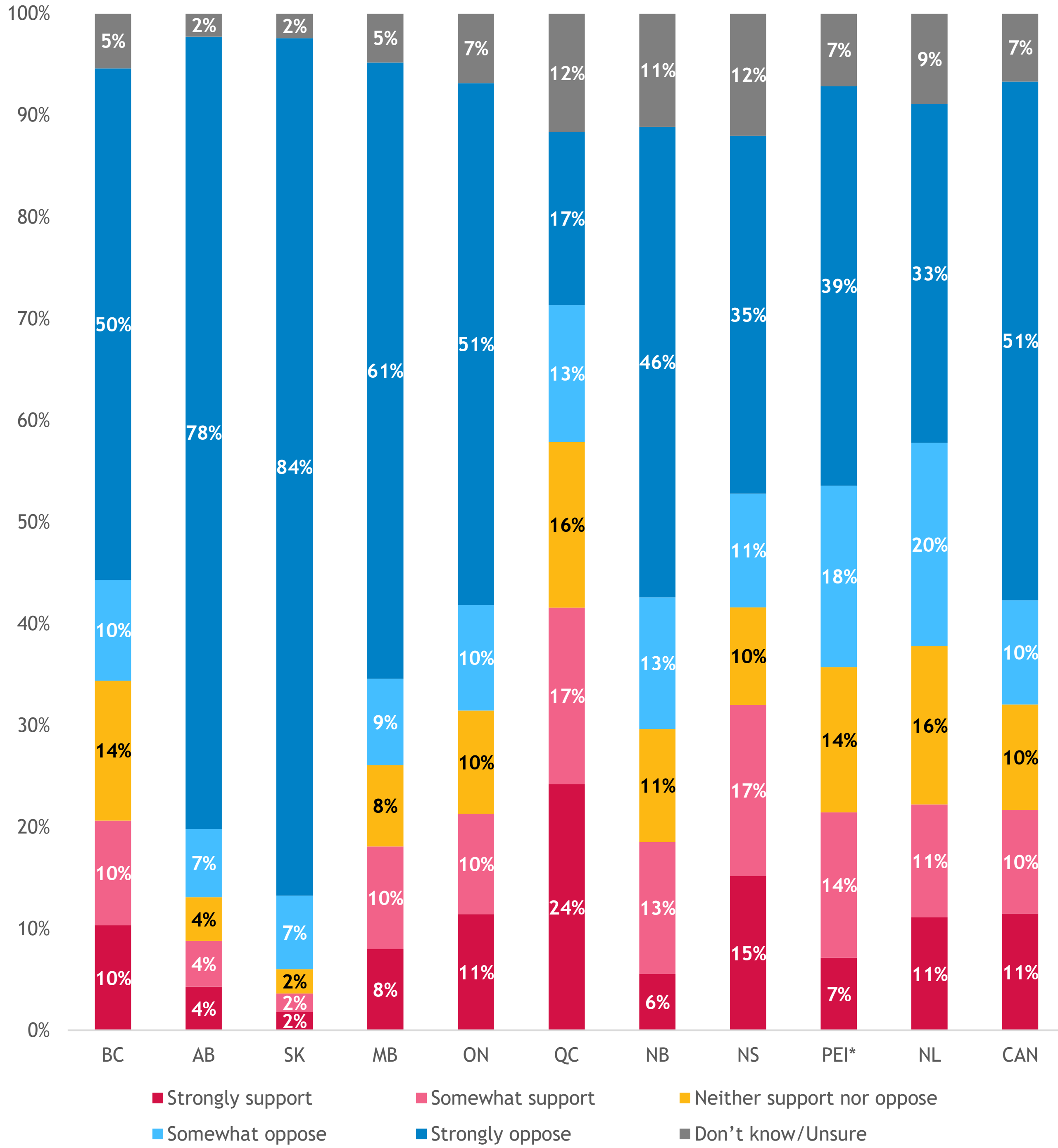
"Banning the sale of new light-duty gas-powered vehicles by 2035 by requiring at least 20% to be zero-emission vehicles by 2026, at least 60% by 2030 and 100% by 2035"



Source: CFIB. National Environment Survey 2022. August 15 - September. 20, 2022. Final results. n= 4,364.
*Low response rate

Figure 2.5

"Increasing the carbon tax from $50 to $170/tonne of carbon dioxide emissions by 2030"



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