



BACKGROUND:

Evaluation of carbon tax backstop costs on domestic air travel: 2019-2030¹

Background

The cost of air travel in Canada will soar if the federal government imposes a carbon tax on air travel in 2019, according to a new study released by the National Airlines Council of Canada (NACC).

The study, *Evaluation of Federal Carbon Tax Costs on Domestic Air Travel: 2019 -2030*, was conducted by AirTrav, a Toronto-based international aviation industry consultancy. It is the third in a series of studies that AirTrav has conducted for NACC to assess how a carbon tax would affect air travel.

The first study in this series, *Carbon Pricing in the Canadian Aviation Sector*, published in May 2018, examined different carbon-pricing options for aviation. It found that a carbon tax would not reduce carbon emissions in the medium term because of the aviation industry's technological and systems maturity with respect to fuel consumption and emissions.

The study also found that a carbon-offset system, similar to that adopted in 2016 by the International Civil Aviation Organization (ICAO) for international flights, was better suited to the industry and would result in measurable emission reductions.

The second study, *Impacts and Analysis of Carbon Pricing on Canada's Trade Exposed Aviation Sector*, published in October 2018, examined some of the more salient market distortions that the backstop carbon tax on air travel would cause.

The current study examines the cost impact of a federal carbon tax on different domestic routes, starting in 2019 with point-to-point flights within New Brunswick, Ontario, Manitoba and Saskatchewan².

The study also examines the effects of a potential national carbon tax on air travel³ between 2022 and 2030 and on the competitive position of Canada's commercial aviation industry and the industry's

¹ The analysis in this report covers the period from 2019 to 2022, plus 2026 to 2030.

² These are the four provinces that did not implement an equivalent carbon-pricing scheme and where the federal carbon-tax backstop will apply beginning in 2019.

³ While the federal Backstop prescribes a carbon tax only on intra-jurisdiction air travel in the first phase, the federal government also signalled in the same document its intention to pursue a "consistent national approach" to pricing carbon emissions from aviation. The market distortions that would be caused by the backstop carbon tax on air travel beginning April 1, 2019, will make implementation of a national carbon tax on air travel inevitable.

long-term sustainability. Finally, the study quantifies the direct revenue windfall that a carbon tax on domestic aviation would generate for the Government of Canada.

Impacts of a federal carbon tax on air travel

The study found that a federal carbon tax would add millions of dollars to the cost of air travel in Canada starting in 2019, almost \$850 million a year by 2030 if the carbon tax is applied to all domestic air travel.

In a vast country like Canada, with a widely dispersed population that relies on air travel, an increase of that magnitude would hurt individuals and families that rely on air travel for work, to visit family, and for basic necessities, such as fresh produce and access to urgent health care. It would also hurt Canada’s visitor economy, encourage even more Canadians to consider lower cost US airports and travel destinations, and jeopardize the long-term sustainability of our aviation industry.

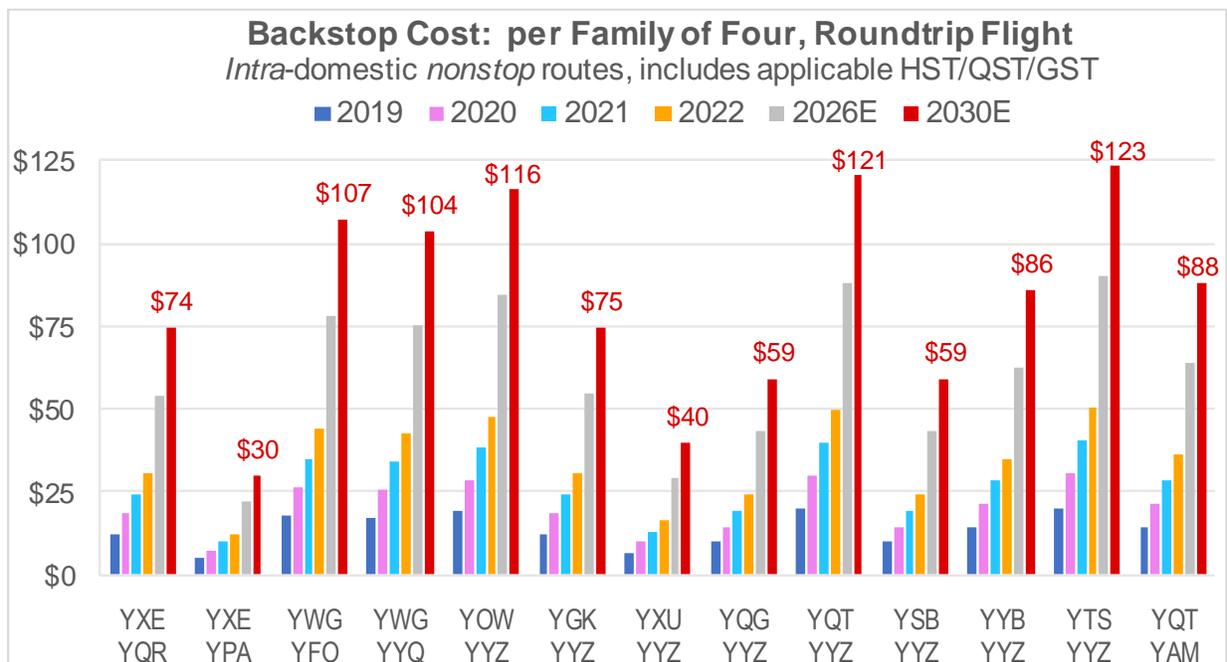
Impact on the traveller

The study looks at the impact of the proposed federal carbon tax in two scenarios:

- 1) between 2019 and 2030, where it would apply on *intra-provincial* (point-to-point) travel within the backstop provinces; and
- 2) between 2022 and 2030, where it would apply to *interprovincial* travel.

The following table illustrates how a federal carbon tax on air travel would affect a family of four travelling between two communities in either Ontario, Manitoba or Saskatchewan (there are no scheduled intra-provincial flights in New Brunswick).

Table 1:



Note the higher cost-impact on air travel from smaller and northern communities as illustrated by flights between Thunder Bay (YQT) and Toronto Pearson (YYZ) as well as between Timmins (YTS) and Toronto Pearson (YYZ).

One of the unintended consequences of a carbon tax as a pricing mechanism for air travel is that it will penalize residents of small and remote communities that depend on air travel. Most flights in and out of these communities use aircraft that are older, less fuel-efficient and smaller, making the per-passenger cost of the carbon tax higher.

Moreover, with the federal government exempting territories from a carbon tax on air travel, air-dependent northern communities in affected provinces would face a growing cost disadvantage with communities in the territories.

For example, a family travelling from Churchill to Ottawa would see the cost of their travel increase by \$350 between 2019 and 2030 as a result of the carbon tax, while a family travelling from Yellowknife to Ottawa would be exempt from the added cost.

This is one example of the market distortions that would be caused by the imposition of a carbon tax on air travel under the current federal carbon-pricing scheme. Table 2, below, illustrates the incremental cost of the carbon tax on non-stop travel between provinces for a family of four starting in 2022.

Table 2:

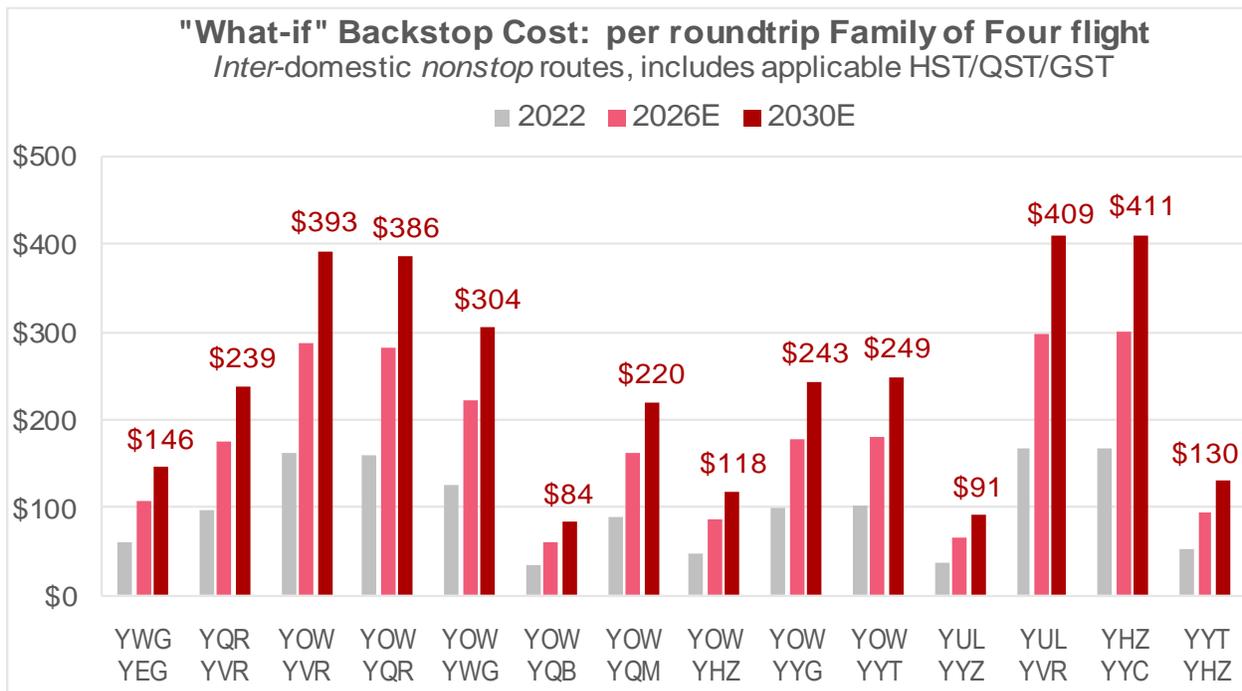
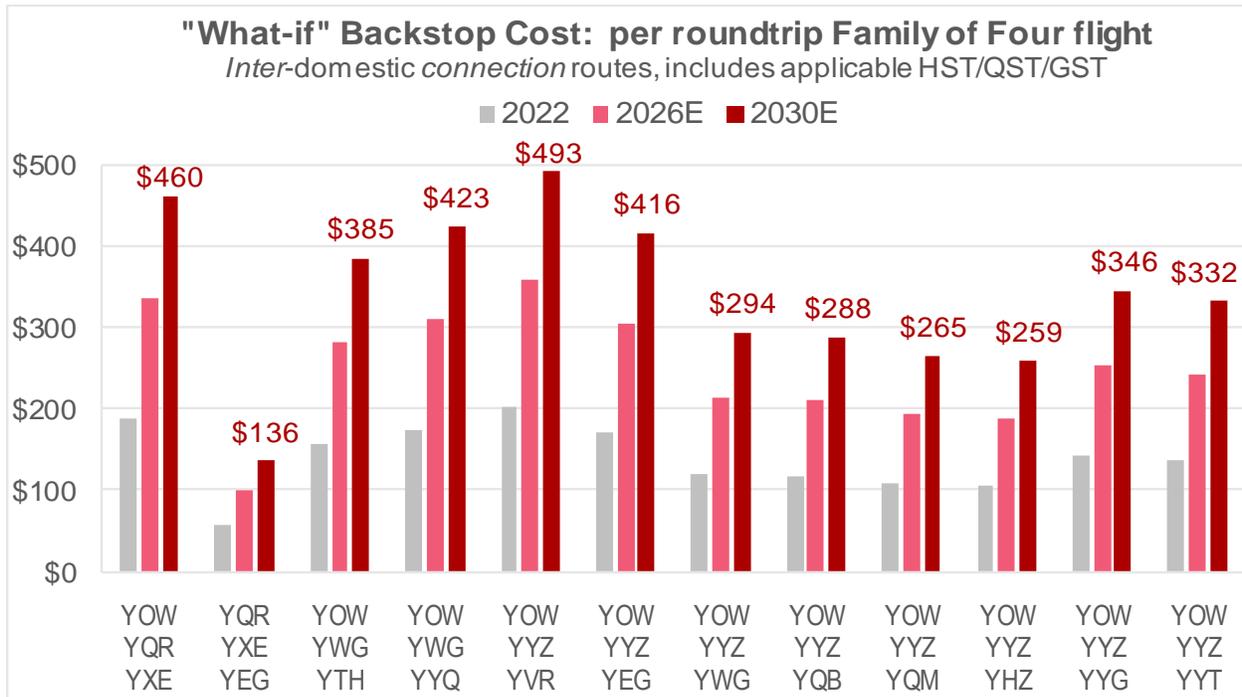


Table 3, below, illustrates the cost-impact of the carbon tax on connecting flights between provinces. The higher relative carbon-tax cost associated with connecting flights would create another market distortion and hurt the growth and development of hub airports, which are essential to an efficient domestic commercial air transport system.

Table 3:



To put these numbers in the context of the federal government’s own carbon-tax cost scenarios, in the scenario below, we examine how the incremental cost of a federal carbon tax on air travel compares to the federal government’s *Climate Action Incentive Payment* (carbon tax rebate) designed to offset additional costs on families resulting from the carbon tax.

William and Joanne are both originally from British Columbia and now live in Ottawa with their two children aged 10 and 12. The children’s grandparents live in Vancouver, and the family visits them once a year during the holidays.

With a federal carbon tax on air travel, William and Joanne would see the cost of a non-stop flight from Ottawa to Vancouver increase by \$150 in 2022, almost \$300 by 2026, and almost \$400 by 2030. If they were unable to fly non-stop and had to connect through Toronto Pearson International Airport, the federal carbon tax on air travel would add \$200 to the cost of their flight in 2022, \$350 in 2026, and almost \$500 by 2030.

Under the federal plan, that Ontario family will be entitled to a \$718 tax rebate in 2022, meaning that 28 percent of the family’s annual carbon-tax allowance would go to offset one flight to visit grandparents in British Columbia.

Impact on Canada's tourism industry

Increases to the cost of air travel caused by the proposed carbon tax, such as those illustrated in this study, would have far-reaching consequences for Canada's tourism industry. These increases would not only conflict with the federal government's plans to grow Canada's visitor economy, they would dampen domestic tourism and encourage Canadians to travel outside the country. In fact, in its currently proposed form, the federal carbon tax displays an unintended anti-tourism bias.

Canada: A high-cost jurisdiction

The 2016 Canada Transportation Act Review report, "Pathways: Connecting Canada's Transportation System to the World," found that Canada's user-pay aviation system was out of step with global competitive realities and put Canada and Canadian air carriers at a disadvantage. Other studies have come to the same conclusion: high taxes and third-party fees make Canada among the most expensive countries in the world for air travel.

According to *Unlocking the Potential of Canada's Visitor Economy*, a study commissioned by Destination Canada for the federal government and recently released by the Minister of Tourism, the already high cost of air travel in Canada is one of the chief obstacles to growing our visitor economy.

According to that study, visitors are most likely to visit three provinces⁴, primarily their largest cities. Encouraging pan-Canadian tourism will require strategies to persuade visitors to choose multiple destinations and stay longer. But the federal government's efforts to boost the visitor economy may be frustrated by the countervailing effects of a carbon tax on air travel.

Our study shows that a domestic carbon tax would add more than \$800 million a year to the cost of air travel in Canada. Moreover, while the current scheme would see part of that increase offset for Canadian residents by the federal *Climate Action Incentive Payment*, visitors to Canada would absorb 100 percent of the cost increases.

It is essential that a carbon tax on air travel – or any additional government-imposed costs on air travel – be considered in the context of their cumulative and compounding impact on the cost of air travel and its system-wide implications.

As the federal government's own study, *Unlocking the potential of Canada's Visitor Economy* suggests, increasing the cost of air travel in Canada would damage Canada's appeal as a visitor destination and, by making it more difficult to develop secondary destinations, would reduce the length of average visitor stays.

An excellent illustration of the potential economic impact of the carbon tax on air travel may be found on page 12 of that study, where the authors discuss the core elements of a growth strategy:

"It also requires developing air travel options, with more flights to major and secondary airports, and improving the public transport connectivity between airports, accommodations, and major attractions in and around Canada's largest cities. Such investments would increase the supply of hotel rooms in

⁴ According to the study, 85 percent of visitors go to Ontario, British Columbia or Quebec, with 74v percent of visitors going to the three main cities in these provinces: Toronto, Vancouver and Montréal.

these cities by 25 to 30 percent, raise annual visitor capacity by 1.8 million, and have \$1 to 1.5 billion in annual direct economic impact by 2030.”

A Carbon Tax on Domestic Air Travel Encourages International Travel by Canadians

To fully appreciate the impact of the carbon tax’s domestic anti-tourism bias, we have to consider how it compares to the carbon-pricing regime in place for international travel.

In October 2016, aviation became the first industry to develop a global sector approach to limiting CO₂ emissions, culminating in the adoption by the International Civil Aviation Organization (ICAO) of the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA). Under this global agreement, aircraft operators purchase offsets, or “emission units,” for growth in their CO₂ emissions above 2020 levels.

When signed in October 2016, CORSIA had the support of both the Canadian aviation industry and the Government of Canada. Minister of Transport Garneau called it an “historic” agreement, with 85 per cent of the world’s emitters participating in a voluntary carbon-offset system beginning in 2021.

As demonstrated in the first AirTrav study, the cost of a carbon tax on domestic air travel would be approximately 10 times that of a CORSIA-like offset carbon pricing system⁵. The cost-differential between the price of carbon of domestic and international flights would therefore create an economic incentive for Canadians to travel abroad.

A carbon tax on air travel will drive more Canadians to US airports and destinations

The AirTrav study not only confirms earlier reports that Canada’s high aviation taxes and fees are driving millions of Canadians to lower cost US airports for international or cross-border destinations, but suggests that a carbon tax on domestic air travel would also affect interprovincial travel. For example, a Toronto passenger needing to travel to Vancouver could drive to Buffalo, N.Y. and fly via a U.S. hub airport to Vancouver to take advantage of lower fares.

Soaring federal windfall

When assessed against a number of the federal government’s stated public policy goals – carbon-emission reduction, avoiding trade and emission leakage, lowering the cost of air travel, growing consumer choice in commercial aviation, growing the visitor economy and tourism in general – a carbon tax on air travel would be a staggering public policy failure.

To understand why the federal government has, so far, resisted applying to domestic air travel a carbon-pricing scheme similar to the international one it applauded in 2016, it may be helpful to

⁵ *Carbon Pricing in the Canadian Aviation Sector*, p. 27

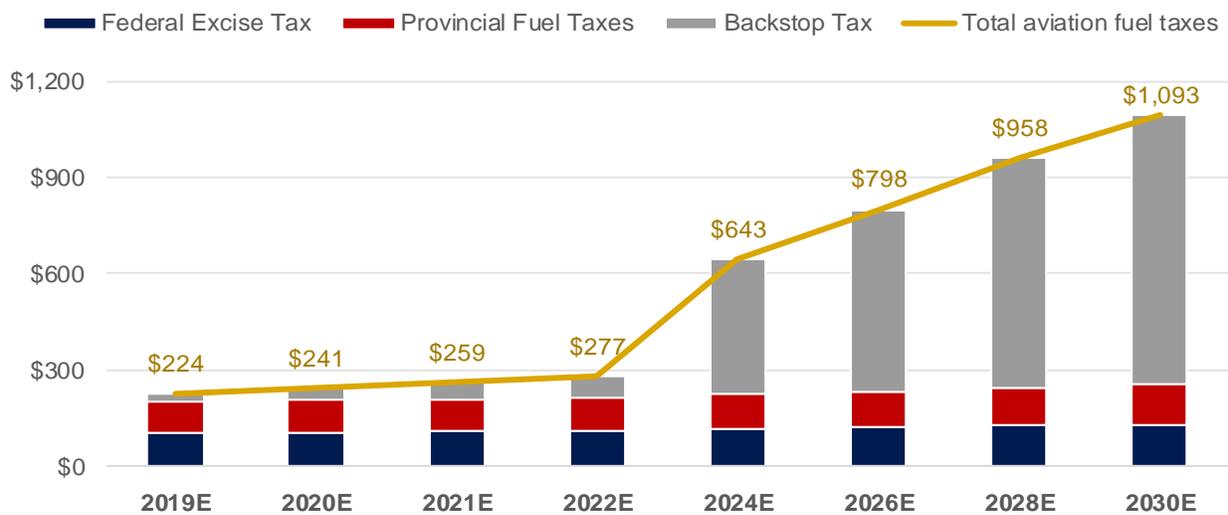
examine the one area of federal public policy where a carbon tax dramatically outperforms a cap-and-trade system: tax revenue generation.

Unlike a carbon offset system, which would generate limited direct tax revenue for the federal government, a carbon tax would raise hundreds of millions of dollars a year. By 2022 tax revenue from the carbon tax would be greater than that from the federal excise tax and provincial aviation fuel taxes combined.

The table below illustrates total projected federal carbon tax revenue from domestic air travel.

Table 4:

Total Projected Government Revenues From Fuel Taxes and Backstop Tax on Canadian Domestic Aviation
(CAD, millions)



CONCLUSION

This study finds that, if implemented, a carbon tax on air travel would add hundreds of millions of dollars to the cost of domestic air travel, curb growth in the visitor economy, penalize small and remote communities, and encourage still more Canadians to explore US airports and destinations.

While this study focuses primarily on the effect of the backstop carbon tax on the pocketbook of Canadians and the resulting effect on demand for air travel in Canada, in order to fully appreciate the policy shortcoming of a carbon tax on air travel one must consider the key finding of the first AirTrav study: a carbon tax will not curb carbon emissions from aviation.

Why is then is the Government of Canada bucking international trends in carbon pricing of aviation? The answer could be an annual windfall of hundreds of millions of dollars it would forego by opting for an offset system. Given the environmental, economic, and social stakes, a windfall is not a good enough reason.