

November 23, 2016

## An Assessment of the Fiscal Impact of Cap and Trade Statement by the Financial Accountability Officer

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Good morning and welcome.

My name is David Wake. I am Ontario's Integrity Commissioner. I have been appointed Financial Accountability Officer on a temporary basis, while Stephen LeClair is on medical leave.

Today, I provided to the Speaker, for tabling, a report that assesses the impact of cap and trade on Ontario's budget balance, that is the surplus or deficit.

The report finds that cap and trade is likely to have an impact on the Province's budget balance, and it concludes with questions that once answered would provide a better understanding of this impact.

I will ask the FAO's Chief Financial Analyst, Peter Harrison, to provide an overview of the report.

### **Context**

The Province has introduced cap and trade to help achieve its greenhouse gas (GHG) emission targets. Under cap and trade, the Province will sell allowances to emit greenhouse gases. In order to track cash flows associated with cap and trade, the Province has established a Greenhouse Gas Reduction Account or GGRA.

Under the *Climate Change Mitigation and Low-carbon Economy Act*, the Province must record in the GGRA all cash inflows from the cap and trade program. The cash outflows from the GGRA may not exceed the balance in the account.

Consistent with this plan, the Province's 2016 budget forecast that cap and trade revenues would be \$1.9 billion in 2017-18 with completely offsetting expenses of \$1.9 billion.

### **Our report does three things:**

- First, it identifies factors that could affect cap and trade revenue.
- Second, whatever revenue is generated, the report finds that a number of factors may lead revenues and expenses to be unequal from year to year, leading to a fiscal impact.
- Finally, it concludes with questions, that once answered, would provide a better understanding the fiscal impact of cap and trade.

## Revenue

The report identifies three key factors that contribute to uncertainty around the revenues from cap and trade:

- First, allowance prices. The price of allowances will be determined at auction and will be driven by supply and demand, which will in turn be affected by factors like the relative costs of switching away from carbon-intensive energy and the overall growth of the economy.
- Second, the Canada-US Dollar exchange rate. Since auctions will set allowance prices in US Dollars, the exchange rate will impact revenue as proceeds are converted to Canadian Dollars.
- The third factor affecting revenue is the number of allowances sold. Because allowances will not be sold below a floor price, it is possible not all allowances offered at any particular auction will be sold, as has occurred in recent Quebec-California auctions.

## Expenses and Fiscal Impact

On the surface, it might appear cap and trade would simply involve funds flowing in from allowance auctions and back out through action plan spending. However, the FAO has identified number of factors that could cause expenses to differ from revenues from year to year, resulting in a fiscal impact:

- Whatever level of revenue the Province achieves from cap and trade, if it uses the funds to finance capital projects or programs that are already planned, cap and trade expenses would be lower than revenues, resulting in a reduction in the deficit or increase in the surplus.
- If the Province commits to spending that is difficult to reduce or stop, and revenues are lower than anticipated, the deficit could be increased or surplus reduced.
- Finally, if the Province simply does not spend all of the cash raised from cap and trade in the same year, it could reduce the deficit in that year and increase the deficit in future years.

Given the uncertainty surrounding revenues and without more specific information on planned expenses, it is too early for the FAO to provide a forecast of the fiscal impact of cap and trade in any particular year. Instead, the report concludes with questions that once answered, would provide a better understanding of how cap and trade will affect the Province's fiscal position.

Thank you.

I am happy to take questions. Il me ferait plaisir de répondre à vos questions.