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INSIGHTS & VIEWS

October 9, 2024

The Other 98.5% of GHGs: How Other Countries' Climate Policies Could Impact Canadian Exports

CLIMATE ACTION TAKEN BY MAJOR TRADING PARTNERS COULD MEANINGFULLY IMPACT MARKET ACCESS AND FINAL DEMAND FOR CANADIAN EXPORTS

- **In 2024 and 2025, countries representing over half of global emissions go to the ballot box. The outcomes of those elections will impact climate policies—and Canadian exports (chart 1).**
- **Countries representing 80% of export destinations, including the US, are implementing or considering border carbon adjustment schemes (i.e. tariffs or charges implemented for emissions-intensive goods at the border). If Canada repeals its carbon pricing system without a suitable replacement, goods responsible for almost two thirds of Canada's total export revenues could see higher costs.**
- **All top export destinations for Canadian goods have, or plan to have, mandatory ESG reporting requirements within the decade. This could see reporting requirements increase for Canadian firms in international supply chains.**
- **Over the longer-term, meeting climate goals could see demand shift, even if none of Canada's top trade partners are on track to GHG reduction targets. Per capita emissions have declined in the majority of top export markets, indicating noteworthy trends.**
- **If policy bolsters capacity supports for exporters, and ensures domestic measures avoid incurring added costs for Canadian trade flows, it can minimize risks and maximize opportunities.**

A WHOLE NEW WORLD

2024 and 2025 are election years for many countries, with implications for climate policy. This year and next, countries representing 50.4% of global GHGs are voting in national, parliamentary and legislative contests. With electoral outcomes now clear for India, Indonesia, the EU and Mexico, the global direction for climate appears to be an "all of the above" energy approach, with expected global growth in both renewable energy generation and fossil fuel production. This represents a continuation of current trends (chart 2), and may be replicated in upcoming elections in the US, Germany and Japan. If this trend holds, it may even diversify high rates of market concentration for non-fossil fuel investments, a welcome benefit for renewables (China, the US and the EU currently **account** for 68% of non-emitting energy investment).

When considering the impacts of climate policy on the Canadian economy, Canadian firms typically look inward, but another story is occurring outside their borders. Canada's economy is highly trade-dependent (chart 3), with exports revenues **accounting** for one third of Canadian GDP in 2023. Canadian exporters already consider growth outlooks, financial conditions and public policies in countries where their customers are located. Yet climate policies in other countries could increasingly shape this outlook as well. Climate policies can create new reporting and compliance obligations, add costs to selling goods to certain customers, or shift demand for high and low emitting goods and services. The actions of major trade partners such as the US, China and UK may influence the policies Canadian governments choose to adopt in turn, particularly if measures like domestic carbon pricing can reduce payments under carbon border tariffs. Recognizing and navigating these challenges will likely grow in importance for Canadian firms and governments in the years to come.

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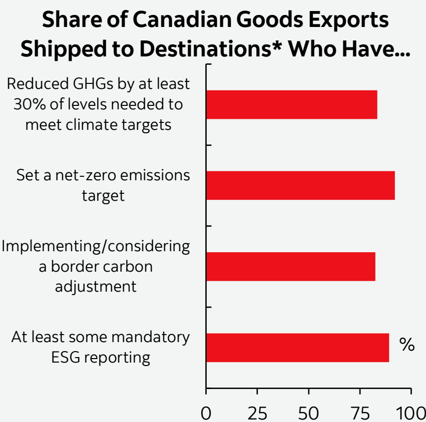
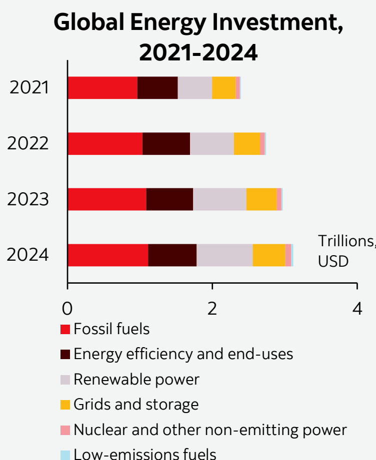
Chart 1



*Analysis includes top 15 export destinations representing 90% of export revenues.
Sources: Scotiabank Economics, IEA, Bloomberg, Statistics Canada, various national/regional climate plans.

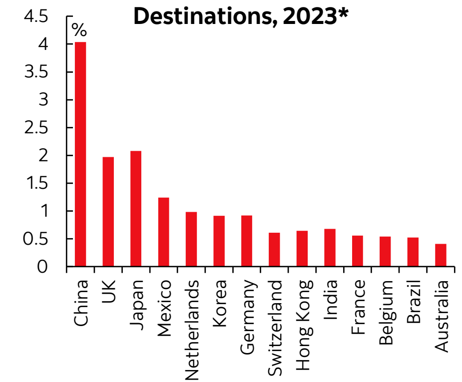
Chart 2



Sources: Scotiabank Economics, IEA.

International climate policies represent two categories of risks/opportunities, which can be divided into measures impacting market access, and trends influencing market demand. Measures impacting market access include navigating emerging environmental, social and governance (ESG) reporting requirements, and the implementation of border carbon adjustments (BCAs). BCAs are a border measure that compensate for differences in stringency between domestic and international climate policies. They either raise the price of imports through taxes, tariffs or charges, set by calculating differences in carbon costs between two countries, or offer subsidies to domestic industry who pay carbon prices. Trends influencing market demand include commitments to reduce greenhouse gas emissions, and progress made towards meeting emissions reduction targets. These challenges can offer both risks and opportunities. Shifts in demand could mean new markets or novel opportunities for Canadian exports of goods and services offering environmental advantages, and changes in market access could benefit firms already reporting on environmental performance in jurisdictions with high carbon prices.

Chart 3

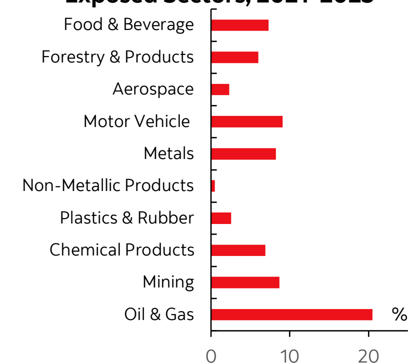


*US excluded for easier comparability.
Sources: Scotiabank Economics, Statistics Canada.

ALWAYS GREENER ON THE OTHER SIDE

Trade data show ESG reporting requirements would impact a majority of exports, with reporting requirements risk impacting exporting SMEs. Many of the top destinations for Canadian exported goods have (or are implementing) policies in place that would impact market access. Of the top 15 countries where Canadian goods are exported, all have or expect to have mandatory disclosure requirements on environmental dimensions of ESG performance for at least some firms operating domestically (specific scope and reporting requirements vary by country). This includes the US, the destination for roughly three quarters of Canadian exports. Supply chain reporting requirements, in particular, could impact market access requirements for Canadian exporters of both inputs and final goods. A 2023 Business Development Bank of Canada study **notes** that sustainability reporting requirements from larger firms will require action from 72% of small-to-medium sized enterprises (SMEs) within five years. This figure is not insignificant, and could be a particular challenge for Canadian SMEs, given that one third of SMEs **identify** "significant" knowledge and visibility gaps around their input sources.

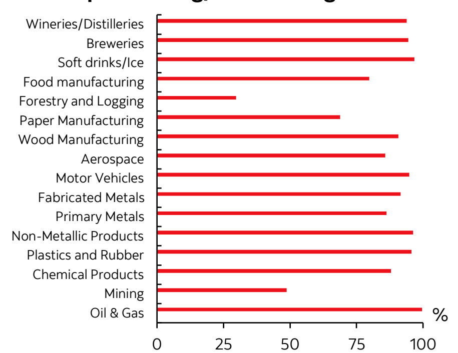
Chart 4



Sources: Scotiabank Economics, Statistics Canada.

BCAs would impact a minority of sectors responsible for a majority of Canadian exports. Currently, no country or region has a full BCA regime in place today, but BCAs have been proposed or are in the midst of being implemented in the EU, UK, US, Australia and Canada (all countries/regions who also have, or will soon have, ESG reporting requirements). Although they could theoretically be applied to every good crossing the border, for practical reasons, BCAs will likely to be limited to sectors where differences in carbon costs would have the highest impacts. These sectors are typically emissions-intensive (raising relative carbon costs) and trade-exposed (greater price sensitivity). Exports from this subcategory of sectors made up 72% of total Canadian exports over the last three years (chart 4). Exports of oil and gas, specifically, accounted for roughly 20% of total exports over the same timeframe, and 28% of total exports from emissions-intensive and trade exposed sectors. From 2021–2023, 84% of exports from these emissions-intensive and trade-exposed sectors went to countries implementing or considering BCAs (chart 5).

Chart 5



Sources: Scotiabank Economics, Environment and Climate Change Canada, Statistics Canada.

The impact of foreign BCAs on Canadian emissions and exports could be material, but impacts will be more explicitly felt if carbon pricing is repealed. If Canada's carbon pricing system were repealed, Canadian companies could face added costs when exporting to countries considering BCAs. Impacts from foreign BCAs could particularly impact SMEs, who make up 93–99% of firms in various EITE sectors, have less internal capacity to track and report environmental performance data, and for whom additional compliance and trade costs

may represent a larger percentage of profits. Although SMEs represent a small percentage of overall export share (limited data **suggests** SMEs account for over 80% of exporting firms by number, but less than 20% of export values), this subset of firms may experience relatively larger effects. The flip side of this risk is that maintaining Canada's carbon pricing system could potentially mitigate it, and might even offer competitive opportunities for Canadian exports to foreign markets, particularly if they compete with substitutes from emissions-intensive economies who do not have a carbon pricing system in place and pay higher costs as a result. A Bank of Canada study identified that implementing a Canadian BCA is unlikely to materially **change** this outlook for exports, but may offer benefits to domestic firms, particularly those with high rates of domestic market share whose competitors would be subject to tariffs.

DEMANDS FOR CHANGE COULD CHANGE DEMAND

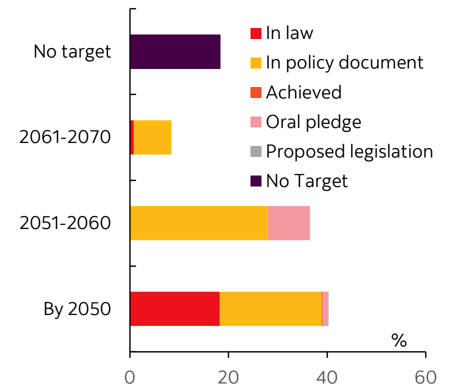
If targets are met, demand would shift dramatically. Multiple **studies** from the International Monetary Fund **indicate** that if efforts to rapidly reach international climate pledges succeed, there is a high chance demand will shift within these countries to non-emitting alternatives, adversely impacting Canada's trade balance and GDP. However, it is often unclear if sufficiently ambitious policies will be implemented to meet targets, and whether they will remain in place if implemented. Overall, 82% of global GHGs are covered by a net-zero target (chart 6). However, only 19% of global GHGs are covered by legislated net-zero goals, with the remaining pledges committed to only in speeches or policy documents (non-legislated commitments are often seen as being less credible). Nearer-term targets would also require emissions reductions across a range of trade partners, but none of Canada's major trading partners are currently on track to meet its goals (chart 7). Further, Mexico and India have set emissions reduction targets that are conditional upon the receipt of international financial support to take action, and it is unclear if this capital will be received. These uncertainties indisputably cloud the outlook for future demand, but the potential for shifts may be substantial.

Yet "not being on track" is not the same as doing nothing. Highlighting that no country is currently on track to meet emissions goals does not fully capture the extent to which demand and investment patterns may be shifting. Per capita emissions have been declining in the majority of major export markets for Canadian goods (chart 8). This trend illustrates that policies, investment behaviors and market actions could be influencing demand in ways that simply looking at headline emissions figures may not identify. These impacts, in turn, could shift demand for emissions-intensive Canadian exports, even if GHGs are not necessarily declining in export destinations. This creates both risks and opportunities for Canadian firms, as market shifts could see growth and/or declines in market share for a range of high and low emissions exports.

THE ENERGY TRANSITION WILL NOT END AT THE BORDER

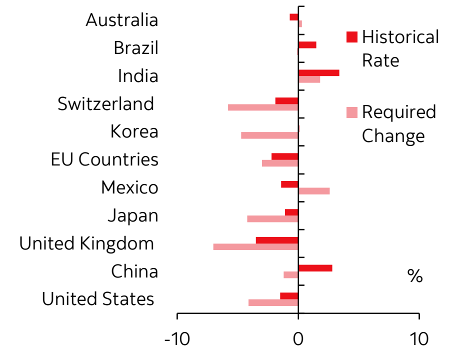
Canadian exporters will increasingly need to consider the climate ambitions of export destinations. As a structural trend, global climate action is likely to continue in some form, and even a slower pace could still offer risks and opportunities for exports in key sectors. The actions of major trading partners will have a large impact, particularly those of the US. To help domestic exporters adapt to changes identified above, Canadian governments should offer capacity development supports to exporting firms navigating ESG reporting requirements and new carbon tariff rules (particularly for SMEs). Serious consideration should also be given to the impacts of potentially **repealing** domestic carbon pricing on Canadian trade flows. If a full legislative repeal leads to higher market access costs for Canadian exporters in the coming years, mitigating that risk will be paramount. Future plans from firms and governments alike will need to take these factors into account as the world enters an era of sustainability-related market access challenges, protectionism and opportunity.

Chart 6



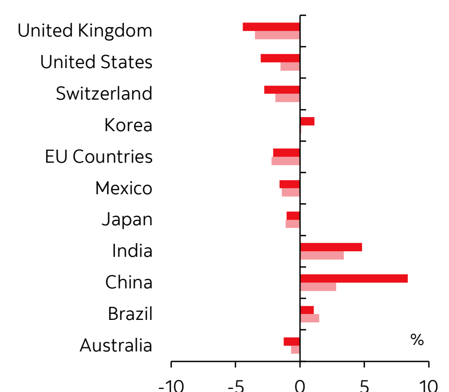
Sources: Scotiabank Economics, IEA.

Chart 7



*"China" represents both China and Hong Kong. "EU Countries" represents France, Belgium, Germany and the Netherlands.
Sources: Scotiabank Economics, IEA.

Chart 8



Sources: Scotiabank Economics, World Bank, IEA.

October 9, 2024

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