

## CARBON PRICING

### Recommendation Summary

The federal government has committed to working with the provinces, First Nations, and stakeholders to introduce a climate change framework for Canada, including a pan-Canadian carbon price. Successfully pricing carbon across Canada would involve policy that adheres to certain principles — most notably that it be broad-based and effective at reducing emissions — and a price that reflects the social cost of carbon. Revenue from pricing carbon should be used, at least in part, for protecting low-income households, further reducing GHG emissions, and investing in the natural and built environment to adapt to climatic impacts.

Prime Minister Trudeau's announcement that the federal government would ensure that there was a pan-Canadian carbon price by 2018 is certainly a step forward. However, there are elements of the announcement that should have been stronger, and others that lack clarity but that we hope will be ambitious when they are finalized. First, a \$10/tonne carbon price starting in 2018 means that it will take many years before the carbon price starts to create significant emission reductions. Second, the default should have been that the carbon price continues to ramp by \$10/tonne per year until 2030, with a review after five years to evaluate whether that ramp is the appropriate one. We have seen with the example of B.C. that when a carbon price stops rising, it can lead to inertia. This means that the federal government will have to be very aggressive with complementary policies — its legislative agenda and spending programs — in order to fill the gap and meet or beat the existing 2030 target.

With respect to revenue recycling, we recommend that the federal government ensure that the money that is returned to the provinces from which it originated is put towards climate change solutions. Those would include investing in clean technologies, energy efficiency programs, and adaptation measures. The federal government should also ensure that a portion of the revenue is returned to low-income households so that they do not spend a disproportionately higher share of their income on carbon pricing.

### Background and Rationale

Economists and climate change experts have long recognized that pricing carbon pollution can be a cost-effective policy tool for reducing greenhouse gas emissions. While a full suite of policies (e.g., regulatory measures, incentives, emissions and energy performance standards, government procurement, etc.) are required to tackle greenhouse gas emissions in a comprehensive way, a price on carbon sends a signal to both consumers and businesses to reduce fossil fuel consumption, use energy more efficiently, and increase the use of cleaner forms of energy.

A carbon price has already been introduced by a number of jurisdictions, both within Canada and internationally. In Canada, at their meeting in March 2016, First Ministers committed to transitioning to a low carbon economy "by adopting a broad range of domestic measures, including carbon pricing mechanisms."<sup>1</sup> The Honourable Catherine McKenna, Minister of Environment and Climate

Change, has described carbon pricing measures as the "most efficient mechanisms" to reduce greenhouse gas emissions.<sup>2</sup> Canadian businesses across economic sectors have also indicated their support for carbon pricing, including those that have joined the Carbon Pricing Leadership Coalition.<sup>3</sup>

#### 1) Principles

A carbon pricing policy could be implemented in a number of ways that would be effective. If rigorously designed, either a carbon tax or a cap-and-trade system could effectively reduce emissions in Canada. Given that a number of provinces have implemented different carbon pricing systems, the challenge for the federal government is to implement a framework that is generally cohesive across Canada and that, over time, converges towards a single, pan-Canadian carbon pricing system. The federal

<sup>1</sup> Canadian Intergovernmental Conference Secretariat. (2016). "Vancouver Declaration on clean growth and climate change." Accessed at <http://www.scics.gc.ca/english/Conferences.asp?a=viewdocument&id=2401>

<sup>2</sup> O'Neil, P. (2016). "McKenna to B.C.: Great job on climate, don't rest on laurels." Vancouver Sun. April 11. Accessed at: <http://vancouversun.com/news/local-news/mckenna-to-b-c-great-job-on-climate-dont-rest-on-laurels>

<sup>3</sup> Government of Canada. "Joint Statement on the Carbon Pricing Leadership Coalition". July 15, 2016. Accessed at: <http://news.gc.ca/web/article-en.do?nid=1099259>

government should seek to implement a carbon pricing system that:

- Sends a broad, relatively equal signal across the Canadian economy by anchoring market-based approaches to carbon emissions reductions linked to international Paris market mechanisms;
- Results in carbon emissions reductions in the near-term and the achievement of Canada's Paris Agreement targets by 2030;
- Encourages increasing ambition in emission reductions, designed with a view toward achieving a maximum 1.5°C temperature increase;
- Generates predictability for business and industry in the near-term, and/or aids corporate planning by clarifying the long-term trajectory;
- Creates revenue streams that can be harnessed to finance other carbon reduction strategies;
- Incentivizes development, manufacturing, export, and use of cleaner technologies, as well as energy efficiency improvements in existing technologies;
- Minimizes leakage and competitiveness concerns; and
- Includes reinvestment considerations in consultation with First Nations, Métis and Inuit peoples of Canada.

## 2) Level of the carbon price

In order for a pan-Canadian price on carbon to be effective and allow Canada to achieve or surpass the Paris targets, it must be set at a level that at least matches the full social cost of burning fossil fuels. Putting a price on carbon emissions that is equivalent to the full costs of those emissions — including the costs of mitigating both climate and air pollution impacts — provides benefits that are many times the macroeconomic cost of applying that carbon price. It is also important to price carbon on a predictably escalating scale at a rate that will provide long-term economic and regulatory certainty, helping to drive emissions reductions over the long-term.

Environment and Climate Change Canada estimates the social cost of carbon—the cost of climate change impacts caused by those emissions at a 3% discount rate—at \$40/tonne and rising.<sup>4</sup> (The U.S. Environmental Protection Agency's estimate is higher.) The cost of local air pollution is, on its own, even higher than the social cost of climate change.<sup>5</sup> An appropriate carbon price could therefore start at a level equivalent to at least the social cost of carbon, and increase annually to reach the price needed

4 Environment and Climate Change Canada. (2016). "Technical Update to Environment and Climate Change Canada's Social Cost of Greenhouse Gas Estimates." Accessed at: <http://www.ec.gc.ca/cc/default.asp?lang=En&n=BE705779-1>

5 Sawyer, D. (2015). "The Benefits of Climate Action to Hard Working Canadian Families." EnviroEconomics. Accessed at: <http://www.enviroeconomics.org/#!/The-Benefits-of-Climate-Action-to-Hard-Working-Canadian-Families/c1uze/55380e170cf21fee1339c111>

to fully account for environmental externalities and achieve climate objectives.

## 3) Revenue

The GBC recommends directing revenues generated by pricing carbon to a few key purposes:

- Reinvesting proceeds into measures that stimulate clean economic growth while maintaining continued downward pressure on carbon emissions, such as modal shifts, decarbonization of the transportation sector, and emissions reductions and efficiency improvements in the buildings sector
- Ensuring that low-income and other vulnerable individuals and families are compensated for the extra costs they face as a result of carbon pricing, and have employment opportunities to participate in the transition to a low-carbon economy;
- Financing adaptation measures, including investments in upgraded infrastructure and nature conservation solutions; and
- Reinvesting in conservation measures on public and private lands as a means of increasing the resiliency and adaptability of the Canadian landscape to a changing climate.

## Complementary policies

Carbon pricing should never be expected to achieve significant emission reductions on its own, since there are significant sources of GHGs that are not sensitive to carbon pricing or have other barriers to tackling them. Especially in the first few years of its implementation, when the carbon price is likely to be below a level that would achieve significant emission reductions, a full suite of policies is required to get Canada on track to deep emission reductions in line with the Paris goal of limiting warming to 1.5 degrees Celsius. These policies would include, for example:

- Legislation and regulations (e.g., accelerated coal phase out, regulations to cut methane emissions, zero-emitting vehicle legislation),
- Spending programs (green infrastructure, Low Carbon Economy Fund, getting remote communities off diesel),
- Incentive programs (deep building retrofit programs), and
- Other fiscal tools (eliminating fossil fuel subsidies).

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