Intelligence MEMOS

From: Benjamin Dachis

To: The Hon. Catherine McKenna, Minister of Environment and Climate Change

Date: January 18, 2018

Re: **KEEP CLEAN FUEL STANDARD IN LOW GEAR**

In 2016, you announced plans to introduce a Clean Fuel Standard (CFS). Before going full-speed with regulations, it is worth pausing to remember that a CFS should, at most, play a complementary role to emissions pricing and may have a high economic cost.

A CFS is an evolution of costly renewable fuel mandates that Ottawa, Ontario, and western Canadian provinces have had in place for many years. Under existing Canadian renewable fuel mandates, fuel sold in Canada must have, on average, between 2 and 8.5 percent (depending on the fuel and province) renewable content.

Among the many problems with such mandates, is that they have no connection to actual emissions reductions. Some types of renewable fuels create more emissions than gasoline over their whole lifecycle. The CFS would mandate instead that the overall life-cycle of emissions from production site to refining and transportation to end combustion be at a set, and declining, threshold of emissions per unit of fuel distributors sell. It is akin to a cap-and-trade program: fuel distributors who sell fuel with emissions below the standard would get credits to sell to those that can't meet the threshold.

California was the first to adopt such a system, with B.C. thereafter, and both at a heavy cost. As of January 5, the price of a CFS credit in California was over $C150 per tonne of emissions. The price has been steadily increasing for years. The cost of emissions reductions for fuel is many times that of emissions permit prices yielding similar reductions in the broader economy. B.C. is the only Canadian province with such a system. The cost there: $164 a tonne in 2017 – way more than the $30 per tonne carbon tax.

A CFS might have a role if it makes an emissions price more effective. For example, households may be slow to change in their gas-guzzler, making a carbon tax a blunt way to change personal vehicle emissions. Businesses may be quicker in adopting more efficient vehicles because of a carbon price because they'll quickly realize a cost advantage. But, this comparison calls instead for a CFS to be targeted to areas it can solve problems more efficiently than economy-wide carbon pricing.

However, Ottawa hasn't disclosed a specific reason for the CFS. All it has said is that it plans to reduce emissions by 30 megatonnes per year with the CFS.

What should Ottawa do? First, we need reliable estimates (like that of one recent study) of the economic cost of its CFS plan compared to a price on emissions. If the economic cost is higher, having both a CFS and a price on emissions needs clear justification.

Second, it should be careful about lumping businesses in with households. Ottawa is going in the right direction with recently released plans to reduce competitiveness concerns from its broader pricing plan. Rather than create two separate regulatory systems – one for carbon pricing and another for fuel distributors – it should give companies the option to satisfy both policies in a single system.

Third, both Ottawa and the provinces need to remove their outdated renewable fuel mandates right away.

Finally, the most important takeaway is that a price on emissions is the best long-term way to reduce emissions. Until carbon prices reach many times their current levels, they will be a more cost-effective way to reduce emissions than a CFS. Policymakers should promote the importance of using efficient ways of reducing emissions instead of stealth policies that have high economic costs.

Ottawa needs to slow down on its CFS and let carbon pricing take the steering wheel on emission reductions.

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