Intelligence MEMOS

From: Tracy Snoddon

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

Date: October 6, 2016

Re: **FEDERAL CARBON PRICE: NOW THE REAL EXCITEMENT BEGINS**

In a C.D. Howe Institute e-brief last month, I called on the federal government to set a carbon price floor and impose a carbon tax in provinces with a carbon price below this floor. On Monday, Prime Minister Justin Trudeau did just that. Provinces have until 2018 to introduce either a cap-and-trade program or a carbon tax; otherwise, the federal government will impose a carbon tax and return the revenues to the province. The plan calls for an initial price floor of $10 in 2018 that rises over time until it hits $50 in 2022.

Canada's prospects for achieving an economy-wide carbon price and cost-effective emissions reductions in line with our Paris commitments just got much brighter. Yet, the announcement also signals a shift in federal-provincial relations on carbon pricing. As the collaborative phase comes to an end, a period of hard-bargaining, posturing and demands for compensation and concessions begins.

Ottawa's move will inevitably spur some provinces to take action between now and 2018. In the wake of the announcement, Manitoba indicated that it will drop plans to join Quebec and Ontario in a cap-and-trade system, and instead introduce a home-grown carbon pricing system. And as the economic burden of the national carbon pricing plan will be unevenly distributed across provinces, temporary measures from Ottawa to address these concerns can be expected.

Politics as well as economics will influence negotiations. Provinces, like Saskatchewan and Nova Scotia, strongly oppose the federal government's plan. Federal-provincial discussions over the next two years will almost certainly centre on measures to appease these recalcitrant provinces. Having the federal government impose a carbon tax and return all revenues to the province could actually be attractive to some premiers, particularly in provinces that face significant administrative or political challenges to implementing a provincial carbon price. By playing the carbon price villain, the federal government takes the political heat for imposing a carbon tax off provincial shoulders. We can expect plenty of grumbling followed by grudging acceptance from some provinces.

All provinces - even those with well-established carbon pricing policies - have an incentive to lobby for special considerations. Alberta has a carbon price in place but has indicated that it will not support Ottawa's plan to increase the price floor unless it gets backing for its pipeline projects. In the Quebec-California cap-and-trade system, the carbon price is expected to reach $18 to $20 in 2020, well below the proposed federal floor price of $30 by that date. Quebec has limited ability to influence the carbon price in the short run with caps and permit floor prices set until 2020. So, Quebec and Ontario may argue for an exemption from the federal price floor at least until after 2020. Nova Scotia may seek concessions for emissions reductions achieved because of its regulation of coal-fired electricity generation.

Implementation of the federal government's proposal will be politically and economically challenging. But as negotiations move to the next phase, and the give-and-take of Canadian federalism really kicks in, Ottawa needs to keep focused on its primary goal of achieving cost-effective emissions reductions in Canada.

Tracy Snoddon is the author of Carbon Copies: The Prospects for an Economy-Wide Carbon Price in Canada