

FEDERAL AND PROVINCIAL CLIMATE CHANGE POLICY AFTER COPENHAGEN

Tracy Snoddon

Had a binding international agreement on climate change emerged from last month's conference in Copenhagen, the federal government would now be under increased pressure to adopt an effective Canada-wide policy to reduce emissions. However, says Tracy Snoddon, without a plan to convince the provinces to give up their existing climate initiatives, we would probably fail to achieve our reduction target or would achieve it at a very high cost. The summit's failure to produce a binding agreement means that Canada now has time to consider how best to implement a cost-effective policy that both addresses provincial concerns about regional burden sharing and compensates the provinces for withdrawing their own initiatives. The author examines some options and argues that a Canada-wide carbon tax coupled with a federal-provincial revenue-sharing arrangement is a cost-effective and workable option.

Si la Conférence de Copenhague du mois dernier avait donné lieu à un accord international ayant force obligatoire, le gouvernement canadien serait aujourd'hui sous pression accrue pour adopter une politique nationale efficace de réduction des émissions carboniques. Mais sans mesures visant à convaincre les provinces de renoncer à leurs propres initiatives climatiques observe Tracy Snoddon, nous raterions sans doute nos cibles de réduction ou ne les atteindrions qu'à un coût prohibitif. Selon elle, l'incapacité de conclure à Copenhague un accord exécutoire procure au Canada le temps d'élaborer une politique qui réponde aux préoccupations des provinces en matière de partage des coûts. Après avoir examiné quelques approches, l'auteure soutient qu'une taxe carbone nationale combinée à une entente fédérale-provinciale de partage des revenus serait une option à la fois sensée et efficace.



In December 2009, more than 180 countries gathered in Copenhagen for the United Nations Climate Change Conference (known as COP15). The main item on the agenda was to reach an international agreement on greenhouse gas emissions reduction targets to replace the Kyoto Protocol, adopted in 1997. The summit failed to generate a binding international agreement. Instead, the conference produced the Copenhagen Accord. Crafted by a handful of the big players — China, the US, India, Brazil and South Africa — the accord is not binding, does not set emissions reduction targets and does not require immediate action to reduce emissions.

The failure of the Copenhagen summit to produce a binding agreement is perhaps good news for Canada, not because we are not committed to the environment but because we need to get the domestic house in order before real action on emissions is possible. Had a legally binding agreement with hard targets and requirements for real emissions reductions emerged from Copenhagen, Canada would be under pressure

to implement policies that are more effective than those that are now in place. However, without a plan to deal with the serious domestic challenges to implementing such policies, we would likely fail to achieve our target or we might achieve it at very high cost. With the Copenhagen Accord, Canada has breathing space to tackle the domestic obstacles that stand in the way of cost-effective climate change policies.

How the burden of climate change policies is shared by provinces is at the heart of the domestic challenges facing Canada. Provincial and federal government bickering, in Copenhagen and at home, is evidence of serious interprovincial conflict on climate. While some, such as Don Martin in the *National Post*, have argued that interprovincial issues can be resolved later, I rather think that effective climate policy for Canada is not possible unless solutions to these interprovincial issues are developed as an integral component of the overall policy package.

Before discussing these issues, it is useful to first outline what is meant by a cost-effective emissions reduction poli-

cy. A policy that puts a price on each tonne of emissions, a carbon price, provides emitters with an incentive to reduce emissions. If all emitters face the same price, emissions reductions are achieved at the lowest possible total cost. A given emissions reduction target could be achieved in a cost-effective manner by implementing a

by province. In our current policy environment, only a small percentage of emissions in Canada face a positive carbon price. The variation in the stringency of provincial policies and in carbon prices tends to redistribute emissions-generating activity within Canada rather than reduce emissions, a problem often referred to as leakage.

the responsibility for the environment and the carbon tax base (sometimes referred to as joint occupancy). With Quebec and British Columbia operating their own carbon taxes, it is clear that provinces have staked a claim to this revenue base. They may be reluctant to relinquish this claim.

The provincial bickering over emissions reduction targets and instruments to address climate change has a lot to do with a concern over who bears the burden, and at present, there is little agreement over how the burden should be shared.

Canada-wide carbon price. The carbon-pricing policy could take the form of either a carbon tax or a hard cap on emissions with a tradeable-permit system. In either case, the carbon price needs to apply to all emissions.

What stands in the way of implementing such a policy in Canada?

First, both the federal government and the provinces have already implemented or proposed their own climate initiatives. Emissions reduction targets differ across provinces and between the federal and provincial government levels. Some of the existing policies put a price on emissions. Both Quebec and British Columbia, for example, have carbon taxes, albeit at different rates. The federal government and a few provinces allow firms to make contributions to a technology fund at a specified price per tonne. And under Alberta's baseline and credit system, emitters can buy provincial credits or offsets or make technology contributions to comply with their reduction targets. Many provinces have joined regional initiatives along with some US states. These initiatives plan to introduce regional cap-and-trade schemes with an emphasis on auctioned permits.

This patchwork of policies is, however, a costly way to reduce emissions. The carbon price varies quite significantly by the source of emission and

To implement a cost-effective climate policy in Canada (i.e., a Canada-wide price on emissions) means addressing our existing patchwork so that all emissions are covered and eliminating the variation in the emissions price by province and by emissions source. A federal carbon tax covering all emissions would work but not if it is simply layered over existing provincial initiatives. This option may not be cost-effective if the variation in carbon prices is not eliminated. So in addition to introducing a Canada-wide carbon tax, provinces would need to eliminate their own pricing policies (i.e., eliminate carbon taxes and withdraw from regional/provincial cap-and-trade plans).

There are two stumbling blocks to moving in this direction. First, research shows that imposing a Canada-wide carbon price to reduce

With Quebec and British Columbia operating their own carbon taxes, it is clear that provinces have staked a claim to this revenue base. They may be reluctant to relinquish this claim.

emissions will be costly, with the potential for a very uneven sharing of the burden across provinces. The provincial bickering over emissions reduction targets and instruments to address climate change has a lot to do with a concern over who bears the burden, and at present, there is little agreement over how the burden should be shared. Second, Ottawa and the provinces share both

For the federal government to take leadership over climate policy in Canada and implement a Canada-wide carbon tax (or equivalently an auctioned cap-and-trade regime), provinces need to know how the federal government

intends to address the uneven sharing of the burden. And in agreeing to give up their own carbon pricing policies and any revenues (actual or potential) that would be generated, provinces will require something in exchange. Without mechanisms to address these two serious obstacles, it seems unlikely that a cost-effective emissions reduction policy can be implemented in Canada. With Copenhagen over, Canada now has some time to work out a solution to these obstacles without the pressure of a binding international agreement hanging over it.

It is important to note that even without an international agreement Canada is still under some pressure to address its climate policy problems, depending on the fate of the US climate bill currently under discussion. Canada's federal government has made it clear that it prefers to harmonize its

policies with those adopted in the US. This was the case before the Copenhagen summit and is still the case now that Copenhagen has concluded. It is worth mentioning that the US climate plan is still in flux, with the latest version before the Senate. However, if the Obama administration is successful, it is unlikely Canada can continue with the status quo. While Prime Minister Harper

may be firm in his resolve to harmonize climate policies with the US, the details of what the federal government wants to harmonize with are still sketchy. In any event, the obstacles of regional burden sharing and joint occupancy must be overcome if the federal government wants to pursue a Canada-wide carbon-pricing policy, along the same lines as the cap-and-trade regime under consideration in the US.

What must be done? While a federal carbon tax is central to an effective climate change policy, the adoption of mechanisms to help ease provincial concerns over regional burden sharing and to compensate provinces for vacating the carbon revenue base is also prominent.

First, Ottawa must share the carbon-pricing revenues with the provinces. Revenue-sharing recognizes that both Ottawa and the provinces have the right to tax emissions and provides compensation to the provinces for giving up these revenues and allowing Ottawa to set the parameters of Canadian climate change policy. Revenues are a way of bringing the provinces to the negotiating table.

Second, the federal government and the provinces need to agree to decentralized revenue recycling. This means that each government is free to determine how best to spend its share of the carbon-pricing revenues. Some provinces might prefer to use their funds to lower distorting taxes while others may use the revenue to ease the burden for key sectors or to invest in clean technology. Decentralized revenue sharing increases the attractiveness of a revenue-sharing deal. Of course, Ottawa and the provinces must first agree on how to share the revenue between the two levels of government and on how to allocate the provincial share across provinces.

Research in regional burden sharing under alternative climate policies is limited in Canada. Existing work suggests, however, that how the revenues are disbursed matters a great

deal to the distribution of the burden of climate policy across provinces. Two possibilities are worth considering.

One is for the federal government to retain all carbon-pricing revenues and allocate these revenues to personal income tax cuts. Existing studies have focused on this type of scenario. Using the revenues to reduce other distorting taxes helps to reduce the overall costs of emissions reductions. At the regional level, Ontario and Quebec are more likely to fare better under this approach since a disproportionate amount of federal personal income taxes are collected from these provinces. This is particularly true for Ontario. This option may not be sufficiently attractive for provinces as they give up all control and receive nothing in return.

A second option is to return all revenues back to provinces with each province's share equal to the carbon-pricing revenues collected from that province. Given the uneven distribution of natural resources and energy-intensive sectors across provinces, Alberta and Saskatchewan will fare better in this case. This option is attractive to the provinces from the perspective that they receive revenues and are free to use these revenues for whatever purpose they choose. On the other hand, this option is unlikely to

these different options if a solution is to be found.

Copenhagen is good news for Canada for two reasons. Canada's behaviour at Copenhagen makes it obvious (if it wasn't already) that inter-governmental conflict over climate policy in Canada is a serious issue that must be addressed. Resolving this conflict is a necessary step in adopting a more effective climate policy for Canada. Copenhagen also buys us some time. While we have only a limited amount of research that focuses on regional burden sharing and alternative federal-provincial revenue-sharing arrangements, Copenhagen has made it clear that we need to focus our attention on mechanisms like these if we are to move forward. Now is the time to study the implications of different revenue-sharing rules for regional burden sharing and to undertake the negotiations over both these components. It is true that these negotiations will be controversial and difficult but it is not obvious that other policy options will be any less so.

With workable solutions to the obstacles that prevent Canada from moving from its current patchwork policy environment to a more cost-effective approach in hand, we will be

Now is the time to study the implications of different revenue-sharing rules for regional burden sharing and to undertake the negotiations over both these components. It is true that these negotiations will be controversial and difficult but it is not obvious that other policy options will be any less so.

be met with complete enthusiasm by the federal government. The federal government bears the political costs of imposing a carbon tax but does not get to keep any of the revenues to help defray the costs. On the plus side, the federal government will likely be successful in achieving the reduction target, which may come with its own rewards. There are, however, a large number of alternatives between these two extremes. Policy-makers need information on the implications of

ready to launch a cost-effective policy when the US is ready to move ahead on climate or when the next climate change conference comes around.

Tracy Snoddon is an associate professor of economics in the School of Business and Economics at Wilfrid Laurier University. This article draws from her paper "Clearing the Air on Federal and Provincial Climate Change Policy in Canada," co-authored by Randall Wigle (IRPP Choices, in December 2009).