

## **Piecing Together the Federal-Provincial Climate Puzzle**

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Federal and provincial ministers will be meeting early in March to discuss how best to move forward with coherent policies aimed at reducing greenhouse-gas emissions. Despite plenty of enthusiasm from the new federal government and a few provinces, the task ahead is daunting, and hard work will be required to sort through the many complex details.

Three primary objectives should be adopted from the outset. First, we should aim to significantly reduce Canada's GHG emissions. There is naturally some disagreement about the magnitude of the necessary reductions, but most informed analysts suggest reductions from current levels of roughly 25 percent by 2030 and of 60 percent or more by 2050.

Second, we should commit to achieving these reductions with the smallest possible economic cost; that is, our policies should be "cost effective". By harnessing the power of markets, carbon pricing offers the lowest-cost approach among all the alternatives. So carbon pricing should form the centerpiece of any overall Canadian policy framework.

Third, the federal government should respect the provinces' right to develop policies in this space. The environment is a shared jurisdiction between the two levels of government, but energy and natural resources—which are clearly connected—lie within the provincial realm. The last thing we need is to rekindle federal-provincial animosities.

Given these three primary objectives, and the fact that some provinces already have well-designed carbon-pricing policies, the big question is how the federal government can play a constructive role in promoting and piecing together a cost-effective pan-Canadian policy framework. This is a lot tougher than it might sound.

Here are five of the biggest challenges to achieving these three objectives.

First, any policies should ensure that all carbon-pricing revenue generated within a province remains in that province, to be used in a way determined by the provincial government. So any federal policies that price carbon need to be accompanied by a promise not to send the revenue to Ottawa—and provinces need to be able to believe this promise. This is easier said than done.

Second, carbon prices should ultimately be harmonized across all regions. This is fair to all households, minimizes the risk that businesses will be put at a competitive disadvantage in some regions, and ensures that our emissions reductions will be achieved at least cost. What process best aligns the various provincial carbon prices? Is the possibility of federal action needed to convince recalcitrant provinces to introduce carbon pricing? And if the feds are needed here, how can we avoid creating federal-provincial tensions?

Third, should the federal government layer its own carbon price on top of the existing provincial prices, or should it leave pricing policies entirely to the provinces? If the former, how do we best integrate the two sets of policies and ensure administrative efficiency? If the latter, how do we achieve a common carbon price across Canada if some provinces choose not to introduce their own policies?

A fourth challenge is California's linkage with the cap-and-trade systems in Quebec and Ontario. This linkage effectively means that the path of the carbon price in our two largest provinces is determined more by California than by any shared objective with other Canadian provinces. Will this "California price" restrict the pan-Canadian price? Will it be consistent with our national objectives for emissions reductions? If not, can the links with California be severed and, if so, at what political price for Ontario and Quebec?

Finally, in order to drive the scale of emissions reductions that we need, carbon prices may have to rise considerably over the next few decades. If there is insufficient political appetite for high carbon prices, will our governments instead be driven to introduce less transparent—but more costly—regulatory policies to do some of the heavy lifting? There is a powerful economic argument to avoid such regulations, but economics often loses in a street brawl with politics.

I don't have simple answers to these many questions, and I doubt that our provincial and federal leaders do, either. And that's really my central point.

Our federal and provincial leaders should not plan on announcing a detailed policy framework in March. Instead, they need to take the time to sort through these and other complex issues about how best to build a pan-Canadian carbon-pricing system that is fair and practical and cost-effective—and also consistent with continued federal-provincial harmony. We should all hope that none of them feels the need to rush.

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