



Perspectives on Carbon Pricing in Canada

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Three basics

- The policy fundamentals – make sure we are talking about the same things
- The political fundamentals – start thinking about how carbon pricing can become politically mainstream
- The way forward – build understanding and invest in options to reduce carbon

Part 1: Policy Fundamentals

- Effort required
- Price or regulation
- Certainty of price or quantity
- Price is taxation
- Aligning with the US
- Costs: administration, transaction, risks of gaming and rent seeking
- Dealing with revenues
- Living in Canadian realities

Effort required

- We are still whistling past the graveyard
- Government objectives for 2020 entail changing the GHG emissions trajectory from **upward** over 1% per year (from 1990 to 2007) to **downward** 2% per year starting in 2010
- According to the NRTEE this scale of change entails an average carbon price across the economy of \$100/tonne by 2020
- \$100/tonne in 2020 equals revenues of \$18 Billion (discounted to 2006), roughly equal to revenues from all corporate taxes in 2020
- Or, another way, \$5.00/gj on the price of natural gas or \$100/MWh on coal fired power

Price or regulation

- Is policy trying to motivate behaviour principally through economic calculus or fear of sanction?
- Cap and trade is a prohibit and penalize program with a side bar carbon market to provide compliance options
- Do we believe that relative price and the expectation of rising relative prices will induce the desired changes in investment and consumption behaviour?
- If so we should design policy to deliver the clearest price signal possible
- If not, we should change the language

Certainty of Price or Quantity

- Quantity matters where:
 - impacts are local or acute
 - the desired and practically achievable level can be defined with precision
- Of all environmental emissions none lends itself to a price approach as much as carbon
 - Every carbon molecule has the same environmental cost and everyone is affected by every molecule
 - Carbon is pervasive in society
 - We have little idea of abatement costs even today far less in the future

Price is taxation

- If the point of the exercise is in fact to create a price as opposed to prohibit and penalize.....
- Then a price imposed by government no matter what the mechanism is taxation in effect and it will be perceived that way by affected entities
- Including the public at large

Aligning with the US

- To minimize competitiveness impacts and avoid trade sanctions
- Does that require detailed alignment?
- Detailed alignment impossible and undesirable anyway:
 - the US system will remain unclear for a long time and what emerges will reflect many special interests
 - it won't be negotiable and Canada's circumstances will argue for many differences
- Canadian variations will become lightning rods for protectionist impulses
- Maybe we should be talking about equivalency of effort and acting like a sovereign nation

Costs

- Cap and trade systems carry high administrative and transaction costs – to set up the system, assess offsets, manage and supervise the carbon market
- As well as very high risk of gaming and rent seeking and risk that entitlements will become locked in
- A tax approach not costless but costs and risks are lower, administrative systems are already in place and it is inherently more transparent
- The argument for accepting the higher costs of cap and trade rests on claims of greater political salability and potential for trading somehow to stimulate innovation

Managing the revenue

- Any system (cap and trade with auction or a tax) will generate very large revenues).
- This will create many winners and losers aside from those created through credit allocation and creation of offsets
- The sooner we starting talking about what to do with the revenues the sooner we may reach a conclusion
- But we aren't talking about revenue because doing so will expose what the system really is

Living in Canadian realities

- Two (at least) things to think about:
- Regional realities
 - political science 101 – the dominant cleavage in Canadian politics is regional
 - significant regional wealth transfers are a bad idea
- Constitutional realities
 - need a national system but the federal criminal power is suited to a prohibit and penalize model, not a price model.
 - taxation? treaty making/trade and commerce? POGG?
 - What is simplest, most constitutionally robust?

Part 2: The political fundamentals

- Carbon pricing will raise energy costs
- Does a pig with lipstick still go oink?
- Carbon pricing applied economy wide and with auctioning of permits produces an outcome in energy end use markets indistinguishable from a tax
- If we want to induce the public to accept carbon pricing we won't do it by trying to fool them.
- But timing, circumstances and approach matter

Bad and good circumstances for discussing carbon pricing

- Bad circumstances
 - energy costs high and rising
 - economic performance and confidence in question
 - state of the electoral cycle makes any debate partisan
 - few people understand the rationale
- Good circumstances
 - there is a debate in train based on the fundamentals
 - those on the podium are not solely or even mainly political partisans
 - those affected have options and some protection from adverse transition effects

Lets just say.....

- We are actually talking about pricing
- We are talking about an economy wide system with auction
- Then we are trying to sell the same thing to the public:
 - one very complex with many potential clever names (cap and dividend?);
 - one very simple and a three letter word.
- The US debate in 2009 is a living experiment as to the proposition that you can fool most of the people most of the time.
- If so then Canada will likely conform somehow but the work of design, convincing the public and making proof against US protectionism lies ahead of us

Part 3: The way forward – a modest proposition

- Build understanding
- Invest in options

Build Understanding

- Start talking about the size of the transformation
- Start talking about what carbon pricing is – an addition to energy costs imposed by government
- Start talking about how to minimize the cost of the transformation :
 - Direct to price is the lowest cost
 - Cap and trade is a poor second choice
 - Regulation alone too costly
 - Subsidy even more costly and ineffective
- Start the conversation on what you do with the revenue
- Explain to consumers what governments can do to facilitate

Invest in options

- Government needs to invest in research, development, demonstration and early deployment across the energy system from carbon capture to community energy systems
- Rethink the role of the regulatory system
 - Since deregulation in the 80's the system has emphasized unbundling of functions, focus on customer near term costs and minimizing cross subsidization
 - The massive upfront investment and high risk entailed in transforming energy systems in our communities calls for a rethinking of the roles of the regulatory system and energy utilities