OBSERVATION

TD Economics

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FEDS STICK TO THEIR CARBON-PRICING GUNS

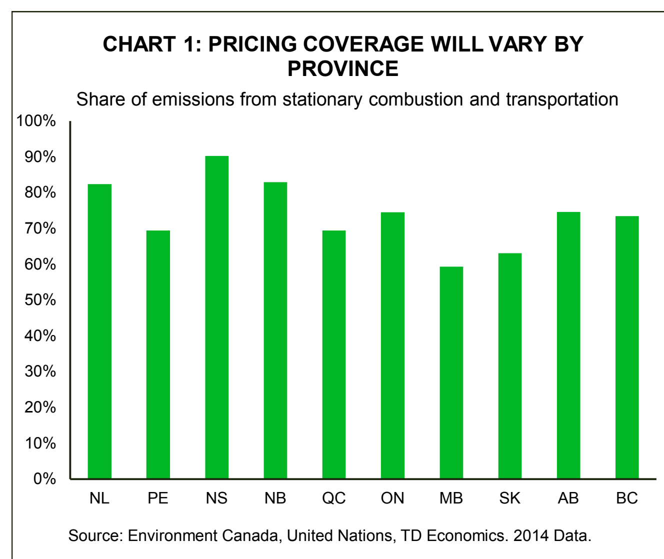
Highlights

- The Federal government today announced further details of the Canada-wide carbon pricing strategy.
- As previously announced, a nationwide carbon price of $10 per tonne (equivalent to about 2.3 cents/L of gasoline) will be mandatory in 2018. The price is to rise by $10 per year to reach $50/tonne by 2022.
- Jurisdictions with cap-and-trade systems must set caps in such a way as to mimic the impacts of direct pricing, and must match the federal goal of a 30% emissions reduction target by 2030, relative to 2005 emissions levels.
- Pricing will apply to fuels and large stationary emitters (i.e. power plants and industrial facilities). Direct agricultural emissions will not be priced.
- For jurisdictions without pricing, the federal government will enforce a "backstop" that includes direct pricing on fuels, and efficiency-based targets for industrial emitters, similar to the provincial pricing scheme in Alberta.
- Carbon pricing may introduce competitiveness concerns, but these can be addressed by using the resulting revenues to lower other economically harmful taxes. Moreover, the "backstop" appears to be designed to have the largest impact on inefficient emitters, helping mitigate competitiveness issues.

The Federal government provided more information today regarding how it will introduce nationwide carbon pricing for 2018. Much of the announcement served to reconfirm previously declared policy guidance, but details of the government's "backstop" pricing measures for provinces that do not have their own policies in place were also provided. While there are still some details have yet to be released, we now have a reasonably clear picture of what nationwide carbon pricing will look like.

Confirming the broad strokes

Many of the carbon pricing requirements outlined today confirmed previous statements. To begin with, carbon pricing on the "main source of GHG emissions" will be mandatory for 2018. The "main source" implies that pricing coverage will need to apply, at a minimum, to the same sources of emissions covered by British Columbia's carbon tax. This means that pricing must cover stationary combustion sources (i.e. power generation and



Brian DePratto, Senior Economist, 416-944-5069

large industrial facilities) that produce 50kT or more of CO_2 equivalent emissions per year, as well as transportation fuels.

Carbon pricing for transportation fuels will clearly impact the agricultural sector given significant inputs to the production process, although there will be exemptions for inputs to certain activities. Perhaps providing some relief, direct agricultural emissions, such as the methane produced by farm animals, will not be subject to pricing. This likely reflects difficulties in measuring these emissions. The result is that the overall stringency of the carbon pricing regime will be slightly lower in more agriculturally-focused regions of the country, as shown in Chart 1, although these regions may choose to implement more stringent coverage than the federally-mandated minimum.

Provinces can choose between cap-and-trade and direct pricing systems. In both cases, stringency must increase through time. Direct pricing must start at $10/tonne in 2018, rising $10 per year to reach $50/tonne by 2022. For cap-and-trade systems, a 2030 target at least as stringent as the national commitment (30% below 2005 levels by 2030) is required. Yearly reductions in the size of the emissions cap must correspond to projected emissions reductions from direct pricing mechanisms. All jurisdictions are required to report on the outcomes of their systems, and a series of reviews will take place ahead of 2022 to help determine the path forward for carbon pricing thereafter.

Enforcing pricing across all provinces

For provinces without their own pricing mechanisms such as Saskatchewan, Manitoba and several Atlantic provinces, the government will enforce a two-pronged approach, similar to the recently introduced Albertan pricing system, with all revenues being returned to the corresponding jurisdiction. For fossil fuels, a direct levy will be introduced, equivalent to the prevailing carbon tax. Table 1 provides a summary of these levies for a selection of major fuel/energy products. The 2018 carbon levy for example, would increase the price of a litre of gasoline in Saskatoon by roughly 2.5%, relative to the gasbuddy.com best reported price for May 17, 2017.

Table 1: Fuel levies for selected fuels, by year

Fuel Type	2018	2019	2020	2021	2022
Gasoline	2.33 ¢/L	4.65 ¢/L	6.98 ¢/L	9.30 ¢/L	11.63 ¢/L
Diesel	2.74 ¢/L	5.48 ¢/L	8.21 ¢/L	10.95 ¢/L	13.69 ¢/L
Natural Gas	1.96 ¢/m^3	3.91 ¢/m^3	5.87 ¢/m^3	7.83 ¢/m^3	9.79 ¢/m^3
Propane	1.55 ¢/L	3.10 ¢/L	4.64 ¢/L	6.19 ¢/L	7.74 ¢/L

Source: Government of Canada

For large industrial emitters, the equivalent of a cap-and-trade system with a price cap equivalent to the direct pricing mechanism (i.e. $50/tonne by 2050) will be introduced. What this means is that firms/facilities that produce emissions above their individual allocations will be able to purchases offsets from those that are below, or, failing this, pay the prevailing emissions levy. An interesting feature of the system is that applicable emissions are to be calculated on a relative intensity basis. Specific details on how intensity standards will be determined are not yet available, but today's announcement suggests that "the output-based standard will be set at a level that represents best-in-class performance (top quartile or better) in order to drive reduced emissions intensity."

In many ways, this system mimics the pricing regime recently introduced in Alberta. This mechanism is designed such that to the extent that large emitters are 'punished', it is not because they are engaged in traditionally carbon-intensive industries, but rather that they are undertaking production in a carbon-inefficient way. Combined with the ability to purchase/sell emissions offsets firms will thus face a clear incentive to reduce emissions while competitiveness concerns vis-à-vis unpriced jurisdictions will be reduced relative to a system that blindly priced all emissions.

Bottom Line

Carbon pricing is the most efficient way of reducing emissions, and today's announcement should help Canada achieve meaningful emissions reductions. However, follow-through post-2022 will be crucial to achieving the 2030 target. The details of the carbon pricing backstop strike a good balance, providing clear incentives for emissions reduction while taking competitiveness issues into account, recognizing that a large industrial base cannot be "turned on a dime" and will continue to face competition from non-carbon priced jurisdictions.

As we have discussed in previous reports, carbon pricing bears the risks of reducing Canadian industrial competitiveness, but at the same time, smart policies can be put into place to reduce these risks. Ultimately, the long-term impact can be to both reduce emissions and improve economic competitiveness and growth, but getting from here to there will hinge crucially on provincial government policies.

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