

Climate Policy Should Focus on Pricing, Not Targets

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The Globe and Mail, December 29, 2015

Now that Canadian policymakers are back from the climate summit in Paris, there will be lots of talk about targets for reducing greenhouse-gas emissions. The federal government has indicated that the previous government's target – reducing emissions by 30 percent from 2005 levels by 2030 – is a lower bound for ambition. And the impending federal-provincial meetings could easily get hung up on how any national target might be divided up among the provinces. But a far more useful conversation would focus on the importance of carbon pricing.

Emissions-reductions targets and carbon pricing are closely related. A broadly based carbon price creates powerful incentives for businesses and households to reduce their GHG emissions. And the higher the price, the more emissions will be reduced, especially over time. So a more aggressive emissions-reductions target requires both a higher carbon price and one more broadly applied across the economy.

Since the problem of climate change is driven by the quantity of GHGs accumulating in the atmosphere, it is not surprising that policy discussions often focus on emissions-reduction targets. What is the appropriate global target? What is the appropriate target for Canada, and how best should our emissions reductions be allocated across provinces and territories? These are natural questions.

But too much focus on these targets can cause us to lose sight of how they will actually be achieved. Unless some well-designed policies are put in place, the targets aren't worth the paper they're written on. There is also a real danger that an excessive focus on targets, and how efforts are divided up among provinces, will lead to bad policy – policy that will hurt rather than help the Canadian economy.

The reason why carbon pricing is such an effective way to reduce GHG emissions is that it avoids the need for a government regulator to determine who should reduce emissions, and by how much. In a complex world in which costs for reducing emissions differ considerably across firms and households, and in ways that no government can ever know with precision, a regulatory approach is very costly. In contrast, a carbon price harnesses the power of free markets to seek out the lowest-cost emissions reductions. Carbon pricing is not just effective at reducing GHG emissions – it is also the lowest-cost of all known policy approaches.

For exactly the same reason that regulations allocating emissions reductions across firms and industries are inefficient and costly for the economy, allocating emissions reductions across Canada's provinces and territories would be unnecessarily costly. We need to avoid this unhelpful national conversation.

But there is nonetheless a conversation we need to have. The upcoming federal-provincial climate-policy meetings will be most productive if the conversation takes three important steps.

The first step is to determine how to ensure that broadly applied and well-designed carbon prices are implemented within each province and territory. Several provinces already have these policies in place or are in the midst of designing them, but more provinces need to get in the game. This would be a natural place to discuss the role of the federal government in helping provinces to design and implement these policies, or even in encouraging some recalcitrant provinces to do so.

The second step is to make sure that the various carbon prices are closely aligned – ideally, equal across provinces. Equal carbon prices ensure that households are treated fairly across the country and also that businesses face no competitive advantages in one province rather than another. The alignment of carbon prices across Canada is a key aspect of the policy's economic efficiency, and it will be natural to discuss whether such alignment can best be achieved by the provinces themselves or with the federal government playing a coordinating role.

The third step is to determine how the carbon prices should rise over time – what should be the rate of increase and what should be the maximum price? These questions invariably bring us back to a discussion of how deeply we need to reduce our total emissions, and over what time frame.

If Canadians want to reduce GHG emissions and maintain a prosperous economy, carbon pricing is the best available policy. And locating these policies within the provinces is both practical and effective. So let's make sure our upcoming national discussion focuses on getting well-designed carbon prices in place, and doesn't get high-jacked by an unhelpful focus on targets.

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