Air emissions from an oil refinery in Alberta, Canada. Source: Bruce Raynor/Shutterstock.com

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Canada has in recent years developed into an unexpected international success story on carbon pricing, joining a club of nations developing robust pricing systems.[1] Just a decade ago, Canada appeared a long-shot for any consequential pricing program, given its substantial oil and gas production, diverse regional economies, and a federal system of government giving regional governments control over natural resources.[2] In turn, its American neighbor and predominant trade partner lacks any national carbon price. Nonetheless, in 2018, Canada adopted a nation-wide price on carbon designed to steadily increase until reaching 170 CAD per tonne in 2030.[3]

Much like the country's public health care system,[4] carbon pricing Canada-style was achieved politically by allowing its ten provinces and three territories flexibility to adopt their own policies and retain control over revenue allocation as long as they met federally-established benchmarks. This included both a fuel tax (or charge) for consumers, for activities like transportation and home heating, and a performance standard and credit trading system for industrial emissions. This policy step appeared to retain fairly solid political support, reflected in Liberal Party-led electoral victories in 2019 and 2021 and public opinion surveys.[5] Ottawa recently committed $7 billion to issue "carbon contracts for difference" to protect industry against any future price volatility.[6] In early December, during COP 28 in Dubai, Canada announced a cap-and-trade system specific to its oil and gas sectors, expanding the federal stable of pricing mechanisms.

Despite this announcement in conjunction with a high-profile international forum, at the domestic political level the relatively smooth ride of carbon pricing has ended. As Canada experiences a housing supply and affordability crisis and inflation, Prime Minister Justin Trudeau and his Liberal government's commitment to its carbon pricing system shows signs of wavering. The policy faces accelerating attacks from provincial premiers. Pierre Poilievre, leader of the opposition Conservatives, has eclipsed Trudeau and his party in recent surveys, regularly pilloring carbon pricing as a major contributor to inflation, despite the head of the Bank of Canada indicating that any economic impact is minimal.[7] Elections loom in either 2024 or 2025.

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1 Rabe, B. 2023. Carbon Pricing Enters Middle Age. Wilson Center.
2 MacDonald, D. 2020. Carbon Province, Hydro Province: The Challenge of Canadian Energy and Climate Federalism. University of Toronto Press.
3 Approximately 127 USD.
4 Boychuk, G. 2008. National Health Insurance in the United States and Canada: Race, Territory and the Roots of Difference. Georgetown University Press.
5 Eberhard, K. 2023. Canada's Federalist Carbon Tax. Niskanen Center Canada's federalist carbon tax - Niskanen Center accessed November 11, 2023.
6 Canada. Department of Finance. 2023. 2023 Fall Economic Statement. FES-EEA-2023-en.pdf (canada.ca) Accessed November 22, 2023.
7 Markusoff, J. 2023 (September 8). There's Now a Bank of Canada Number for Carbon Tax's Impact on Inflation. It's Small. CBC News, accessed November 21, 2023

During the pandemic, the federal government looked the other way when several provinces reduced their local fuel taxes to offset the federal fuel charge, blunting the overall emissions impact. At the end of 2022, the federal government released benchmark standards through 2030, eliminating exceptions, increasing national uniformity, and covering home heating oil. But in October 2023, Trudeau announced a three-year pause on this extension. While heating oil is not used widely in homes outside of rural areas and Atlantic Canada, this decision triggered a chorus of calls for additional exemptions, including natural gas for home heating and all fuels used in farming. Saskatchewan provincial authorities have recently removed the federal carbon price from home heating bills, likely triggering a major constitutional test.

The prognosis for carbon pricing in Canada seems increasingly bleak, perhaps following an "adopt-then-reverse" pattern experienced elsewhere, including American states and Australia. However, three points suggest that any forecast that Canadian carbon pricing is collapsing may be premature.

First, provincial opposition to the federal carbon price is hardly uniform. Quebec and British Columbia have maintained bipartisan carbon pricing support for over fifteen years. Both provinces worked with Ottawa to establish the federal system. Indeed, the federal policy for the consumer fuel charge is modeled after the BC carbon tax, which has successfully reduced emissions while remaining progressive economically.[8] Both Quebec and BC would likely retain their own policies even if the federal system fell apart.

In turn, Ontario, Canada's most populous province, has oscillated between support and opposition to carbon pricing depending on the political party in government. Doug Ford, the current Progressive Conservative premier, has vociferously opposed the consumer fuel charge, but has worked with the federal government to develop an industrial pricing system while investing in Ontario's auto manufacturing industry's transition to electric vehicles and batteries. Like Trudeau, Ford's political future is uncertain and carbon pricing support could increase should other prominent parties take control. If Ontario joined Quebec and BC in supporting the consumer fuel charge, this would cover about three quarters of the population and one-third of Canada's GHGs.

Other provinces might join this coalition-of-the-willing on pricing. The four Atlantic provinces and Manitoba, which constitute about 10 percent of Canadian GHGs, have at times supported the federal plan and might be brought back on board with adjustments in federal policy design. This explains the federal government's decision to pause tax collection on home heating oil most commonly used in Atlantic Canada. Provincial government changes could also alter Canada's carbon pricing landscape. Indeed, Manitoba's recently elected left-of-center government might be more amenable to a consumer fuel charge.

Collectively, the clear majority of provinces are likely to either sustain or consider extended support for carbon pricing, particularly if Ottawa agreed to some adjustments, perhaps slowing the planned rate of increase or adjusting for inflation. Consequently, multiple provinces might

8 https://x.com/ProfKHarrison/status/1724874346219405691?s=20

actively oppose any future Poilievre government effort to eviscerate the fuel charge and eschew any serious alternative emission-reduction strategies. Such a provincial-federal ricochet strategy has abundant Canadian precedent.[9]

Of course, two provinces, Alberta and Saskatchewan, remain unalterable foes of pricing or most other climate policy strategies, representing just under half of Canadian emissions. Both provinces have long histories of opposing any climate policy that would affect their far-reaching oil and gas or agricultural industries. They challenged the federal carbon pricing system in the Supreme Court of Canada, where they lost. These provinces would be extremely unlikely to retain the carbon price on consumers should the federal government not compel them to do so. They are also leading efforts to block or weaken the proposed cap-and-trade system for the oil and gas sectors and plans for a Canadian net-zero electricity grid by 2035.

Second, increasing fuel charge rates produce increasing amounts of revenue, the bulk of which are returned to Canadian citizens in the form of tax-free "climate action incentive payments." These represent lump-sum rebates that are larger for most households than the charges that they pay.[10] In the Saskatchewan case, for example, ending fuel charge collections for home heating bills may be popular politically but this will also reduce those payments, potentially proving unpopular. Research that includes the Canadian system in its early stages shows that revenue return of this type does not necessarily boost political support for carbon pricing.[11] However, less is known about this dynamic in cases where the system is designed to steadily increase benefit payments over time but faces possible political elimination, potentially increasing program visibility and political support. Significant public awareness of these transfer payments and support to maintain them could bolster the Canadian carbon pricing system. To that end, in July 2022, the federal government switched from an annual tax rebate to quarterly payments made directly to citizens to increase visibility. Whether this administrative change moves the needle on public support for carbon pricing remains to be seen.

Third, most of the current controversy focuses on a consumer fuel charge but Canada also places a carbon price on industrial emissions, which has proven much less politically controversial. Manitoba, Yukon and Nunavut have adopted the federal system while the ten other provinces and territories have created their own versions that thus far meet the federal benchmark. Industrial emissions constitute about 40 percent of Canada's GHGs, although only large industrial facilities pay through this system.

If the consumer fuel charge proves politically infeasible, Canada could expand its industrial pricing system to include smaller facilities (those above 10,000 tonnes already report their emissions although only those over 50,000 tonnes are covered) and perhaps raise the system's price signal to try to make up some of the difference lost in the removed fuel charge. Another

9 Boyd, B. 2017. Working Together on Climate Change: Policy Transfer and Convergence in Four Canadian Provinces. Publius: The Journal of Federalism 47(4), 546-571 https://doi.org/10.1093/publius/pjx033

10 Tombe, T., and Winter, J. 2023 (December 7) Carbon Pricing is not to blame for Canada's affordability challenges. Policy Options.

11 Mildenberger, M., et al. (2022). Limited impacts of carbon tax rebate programs on public support for carbon pricing. Nature Climate Change.

option would be to introduce additional pricing or regulations for individual sectors, similar to the one proposed for the oil and gas sectors. Using either of these approaches would shift the price upstream to industrial activity and avoid targeting consumers at the gas pump or on monthly utility bills. Of course, costs borne by industry may simply be passed down to individuals. But this shift could make the policy less prone to the kinds of partisan political attacks and public scapegoating increasingly common in Canada in recent months, possibly emulating durable carbon pricing programs such as the European Union's Emissions Trading System. Blending strengthened industrial pricing with some expanded government investments to support industry emissions reduction may open a politically sustainable policy path.

Political adjustment of the existing industrial system, however, likely would not produce enough emission reductions to offset the loss of the fuel charge. A recent report from the federal Environment Commissioner, an independent government watchdog, found that even with pricing and all other existing policies, Canada is unlikely to meet its 2030 GHG targets.[12] The industrial system focuses on intensity (emissions per unit of production) rather than absolute emissions, applied only to emissions over an established performance standard. Attempting to develop additional pricing mechanisms, regulations, or emission targets for sectors like electricity, vehicles, and oil and gas production, has proven challenging even when done in concert with provinces and territories. Most sector specific regulations would likely be jettisoned or weakened under a federal Conservative government.

One area where there may be some cross-party consensus would entail expanding subsidies to citizens to purchase more climate-friendly products like electric vehicles and heat pumps or to industries to acquire technology to reduce their emissions. However, there is no evident groundswell of Canadian political support to attempt to replicate America's massive subsidy-centered climate path. Any new Canadian funding programs would compete with salient sectors such as housing and Trudeau contends that Canadian scaled investments to match the United States would imperil Ottawa's credit rating. Thus far, federal Conservative leaders have not hinted as to how they might try to address emissions reductions in the absence of pricing or a major downsizing of regulatory ambition.

Recent developments also raise the question of how a Canadian carbon pricing pivot would be received by its major trading partners and the international community. The European Union has envisioned Canada as a major ally in its plan to launch a global carbon border adjustment mechanism in 2026, linking carbon fees on imports to its increasingly robust continental carbon price.[13] The United Kingdom is moving in a parallel direction and other major industrial nations are considering comparable steps. A diminished domestic pricing regime might result in Canadians facing European carbon import fees. Any move to scale back the carbon tax, such as the temporary home heating oil exemption, could also inhibit Canada's ability to apply a

12 Commissioner of the Environment and Sustainable Development. 2023. Canadian Net-Zero Emissions Accountability Act – 2030 Emissions Reduction Plan. Report to the Parliament of Canada Report 6—Canadian Net-Zero Emissions Accountability Act—2030 Emissions Reduction Plan (oag-bvg.gc.ca) Accessed November 21, 2023.

13 Smith, I., et al. 2023. The EU's CBAM and Its Significant Others. Journal of Common Market Studies. 2023. https//doi:10.1111/jcms.13512

carbon border adjustment under the United States-Mexico-Canada Agreement to US goods entering the country and open the door to exemption demands from south of its border. In short, if Canada moves towards an American-style climate policy approach that eschews pricing, the hurdles to expanding or increasing the carbon pricing regime in the future will continue to mount both inside and outside the country's borders. Canada launched a carbon border adjustment consultation last year, which will be interwoven with the fate of domestic pricing.

The carbon emissions intensity of Canada's economy is comparable to the United States, but both remain considerably higher than other major trading partners such as Europe, the United Kingdom, and Japan.[14] Squaring its avowed climate leadership aspirations with its actual emissions will require Canada to maintain some consequential form of domestic carbon pricing alongside significant complementary policies. The same will apply should Canada seek full membership in any national carbon club that links carbon pricing with global trade policy. Ironically, Canada's possible shift away from pricing would further underscore North American political challenges in utilizing this core climate policy tool, despite its expanding role in Europe and Asia.[15]

14 Pomerleau, S. 2023. Is the US Really a Global Leader in Low-Carbon Industry? Niskanen Center. Is the U.S. really a global leader in low-carbon industry? - Niskanen Center accessed November 21, 2023.
15 World Bank. 2023. State and Trends of Carbon Pricing 2023.

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Thinking Canada is a series of commentaries and working papers on public policy issues in Canada, topics relevant to U.S.-Canadian relations, and the North American region. The views of the authors are their own and are published by the Woodrow Wilson International Center for Scholars through its Canada Institute to promote greater awareness and insight on the United States' neighbor and longstanding partner.

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