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MEMORANDUM TO MINISTER

AUG 1 2 2022

UPDATE ON THE PRICING CHALLENGE AND CARBON PRICING WORLDWIDE

(For Information)

PURPOSE

To update you on the Prime Minister's global carbon pricing challenge and to provide you with information on the current status of global carbon pricing as covered by the World Bank State and Trends of Carbon Pricing 2022.

SUMMARY

- ECCC is working with the Privy Council Office to advance the Prime Minister's global carbon pricing challenge, including developing plans for a high level event at the 27th Conference of the Parties to the UN Framework Convention on Climate Change (UNFCCC) (COP27) and options for a new carbon pricing commitment to be showcased at the event. The short timeline to COP27 will be a key consideration.
- Next steps to advance the Prime Minister's global carbon pricing challenge in the near term include
COP27 event and the development of a webpage.
- The World Bank State and Trends of Carbon Pricing 2022 (**Annex I**) provides an update on the status of global carbon pricing, finding that 68 carbon pricing instruments currently in operation cover approximately 23% of total global GHG emissions, a modest increase from 21.5% in 2021.

s.15(1)
s.21(1)(a)
s.21(1)(b)

CONTEXT AND CURRENT STATUS

At the 26th Conference of the Parties to the UNFCCC (COP26), in November 2021, Prime Minister Trudeau issued a challenge to all countries to triple the global coverage of carbon pricing from around 20% of global GHG emissions to 60% by 2030. Subsequently, the 2022 Leadership report of the Carbon Pricing Leadership Coalition, which is led by the World Bank, published a commentary by the Prime Minister, in which he reiterated the challenge and called on governments and business to make new carbon pricing commitments at COP27. The Prime Minister also stated that Canada will be ready with a new commitment of its own to help guarantee the future price of carbon pollution.

Canada has also sought to promote carbon pricing through various bilateral and multilateral engagements. For example, in June 2022, Prime Minister Trudeau and President Boric of Chile made a joint statement committing the two countries to cooperate on advancing global carbon pricing both bilaterally and in multilateral fora. The statement also commits the two countries to work together to convene an event at COP27.

World Bank analysis of carbon pricing coverage in its State and Trends of Carbon Pricing 2022 provides a baseline for the Prime Minister's challenge. The 2022 report confirms that carbon pollution pricing is gaining traction internationally and remains a key pillar in reaching the commitments under the Paris Agreement.

Despite this trend, global coverage remains low. Currently, there are 68 carbon pricing instruments in operation round the world, including taxes and emission trading systems, with 3 more scheduled for implementation in Indonesia, Austria, and Washington state. These instruments cover about 23% of total GHG emissions, a modest increase in coverage from 21.5% in 2021.¹

The World Bank report finds that fewer than 4% of global emissions are currently covered by a direct carbon price at the level needed to drive the reductions needed by 2030. Nevertheless, the price levels in many emission trading systems are hitting record highs, including in the European Union, California, New Zealand, and the Republic of Korea. Several jurisdictions have established more ambitious carbon price trajectories, including Canada, Singapore, and South Africa. In addition, several carbon taxes are also hitting their highest levels yet. Price levels in emission trading systems have been driven up by a combination of policy reforms, economic trends, investments, and anticipated investment interest in upcoming years.

In addition, global carbon pricing revenue increased sharply by approximately 60% in the past year, totalling around US\$84 billion. Increasing price levels, combined with reduced free allocations, led to revenues from emission trading systems surpassing carbon tax revenues for the first time.

The World Bank also points to the increased work on cross-border approaches to carbon pricing. These approaches have the potential to fortify domestic support for carbon pricing and prevent carbon leakage. Some examples of approaches include:

- border carbon adjustments, currently being developed by the EU and being considered by Canada, the United Kingdom, and others;
- the Climate Club promoted by Germany through the G7;
- the international carbon pricing floor proposed by the International Monetary Fund and the World Trade Organization; and
- the proposed U.S.–EU carbon-based sectoral arrangement on steel and aluminium trade.

s.21(1)(a)

s.21(1)(b)

¹ The World Bank report provides the baseline for the Prime Minister's challenge.

Other trends identified in the World Bank analysis include:

- credits from independent mechanisms clearly dominating a rapidly growing market, with compliance demand for credits remaining limited;
- diverse purchaser preferences, such as high demand for nature based credits and carbon removals, leading to uneven growth; and
- the emergence of new financial services, technologies, and governance frameworks for carbon markets adding complexity to carbon credit markets and creating divergent approaches between parties.

CHALLENGES AND CONSIDERATIONS

ECCC is working closely with the Privy Council Office to advance the Prime Minister's global carbon pricing challenge and prepare for COP27. Following on the Prime Minister's commentary in the Carbon Pricing Leadership Coalition's 2022 Leadership report and the joint statement with President Boric of Chile, ECCC is working with the Privy Council Office on the following:

s.15(1)

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s.21(1)(a)

s.21(1)(b)

- confirming the focus of a COP27 event; and
- creating a webpage to highlight the Prime Minister's global carbon pricing challenge.

ECCC is working with the Privy Council Office to prepare a draft concept note for a high level event at COP27,

ECCC is also preparing a concept note for a technical event on expanding carbon pricing globally.

s.15(1)

s.21(1)(a)

s.21(1)(b)

Overall, the lead time for the planning and organization of an event at COP27 is short, considering that


Looking forward to 2030, the challenge issued by the Prime Minister require that various challenges be addressed, Success will

The objective of the Prime Minister's global carbon pricing challenge is to promote the use of carbon pricing as one of the most effective policy tools to reduce GHG emissions, whereas other initiatives are more explicitly focused on addressing the risk of carbon leakage and adverse impacts on competitiveness.

NEXT STEPS

- ECCC will continue to work with the Privy Council Office and your Office to advance the Prime Minister's global carbon pricing challenge with a focus on COP27 as priorities in the near term.

T. Christine Hogan
Deputy Minister
c.c. Paul Halucha



Paul Halucha
Associate Deputy Minister
c.c. T. Christine Hogan

Attachment (1):

- *Annex I – Executive summary: State and trends of carbon pricing 2022 (World Bank)*

BACKGROUND

Based on ECCC analysis of

ECCC has proposed that letters from the Prime Minister be sent to countries and organizations:

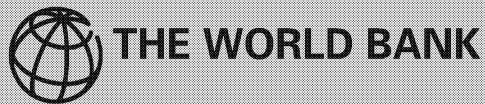
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the CO26 high level dialogue on carbon pricing where the Prime Minister's global carbon pricing challenge was announced. Discussions with the Privy Council Office are ongoing to confirm

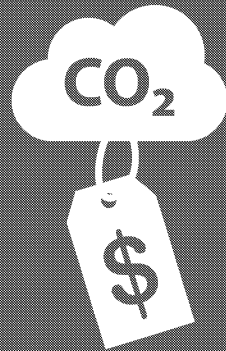
Figure 1 and Figure 2

Executive summary

State and Trends of Carbon Pricing 2022

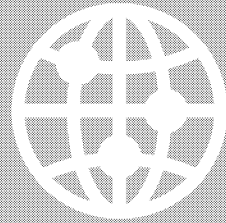


Executive summary



CARBON PRICING CAN PROVIDE THE IMPETUS FOR ECONOMIC TRANSFORMATION AND RECOVERY

- More ambitious carbon prices can help close the gap between pledges and policy and “keep 1.5 alive.”
- Along with lowering emissions, carbon pricing can improve energy and industrial efficiency, limit reliance on imported energy, promote cleaner air, protect and regenerate landscapes, and provide a valuable source of government revenue.
- But adopting carbon prices remains politically challenging, particularly amid rising inflation and energy prices. There is a clear need to ensure policies are fair, effective, and embedded within integrated climate and social policies.



DIRECT CARBON PRICING CONTINUES TO BE ADOPTED BUT GLOBAL COVERAGE REMAINS LOW

- Worldwide, 68 carbon pricing instruments (CPIs), including taxes and emissions trading systems (ETs), are operating and three more are scheduled for implementation.
- CPIs in operation cover approximately 23% of total global greenhouse gas (GHG) emissions. This represents a small increase in total global coverage as a result of four new systems commencing in the past year.
- The International Maritime Organization is considering placing a price on emissions from international shipping activities. If adopted, this would represent a major step in tackling global GHG emissions.

MAP OF CARBON TAXES AND EMISSIONS TRADING SYSTEMS

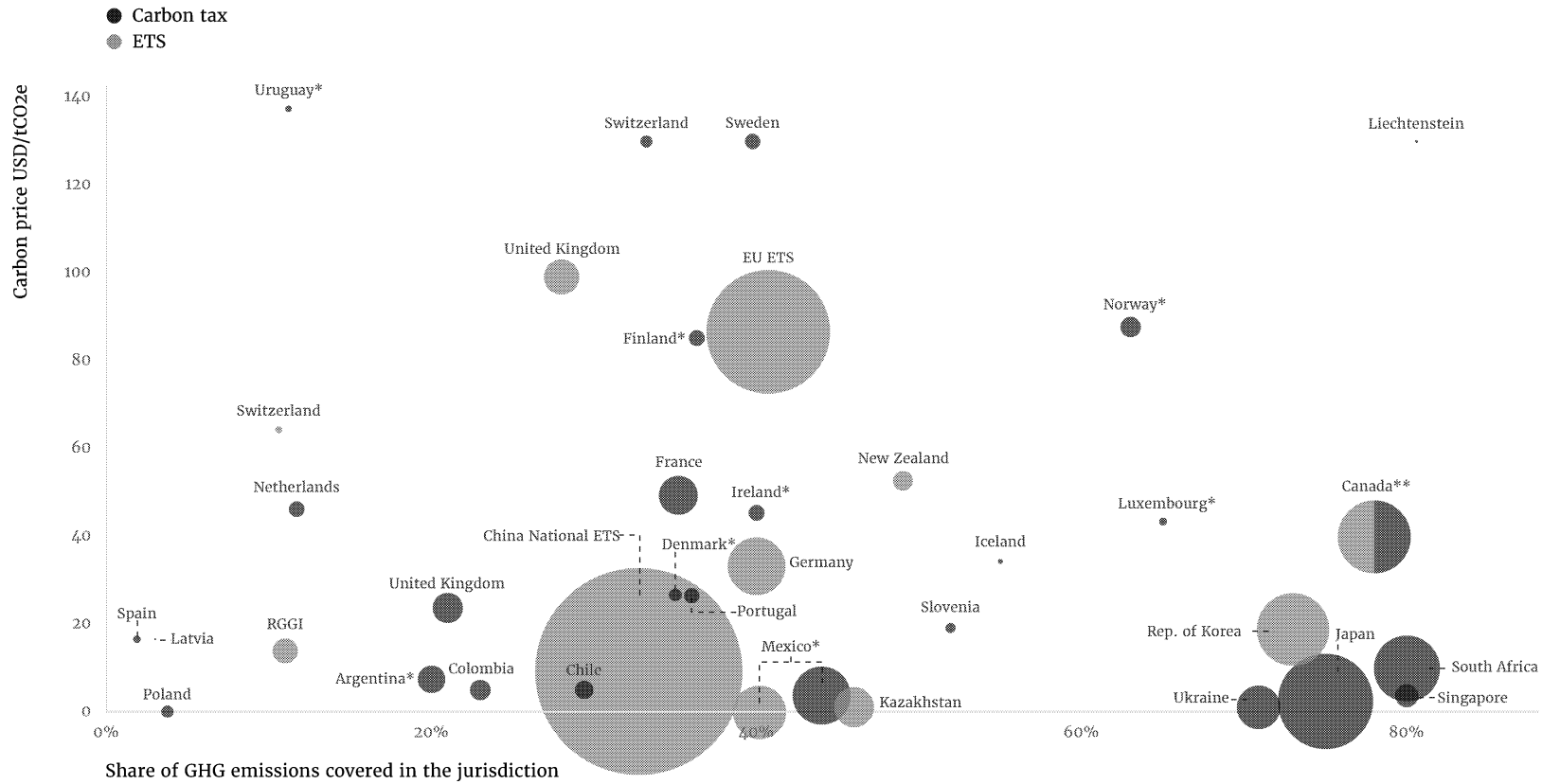


- ETS implemented or scheduled for implementation
- Carbon tax implemented or scheduled for implementation
- ETS and carbon tax implemented or scheduled
- ETS implemented or scheduled, carbon tax under consideration
- Carbon tax implemented or scheduled, ETS under consideration
- ETS or carbon tax under consideration

Carbon pricing initiatives are considered "scheduled for implementation" once they have been formally adopted through legislation and have an official, planned start date. Carbon pricing initiatives are considered "under consideration" if the government has announced its intention to work towards the implementation of a carbon pricing initiative and this has been formally confirmed by official government sources. TCI refers to Transportation and Climate Initiative. RGGI refers to the Regional Greenhouse Gas Initiative.

Executive summary

ABSOLUTE EMISSIONS COVERAGE, SHARE OF EMISSIONS COVERED, AND PRICES FOR CPIs ACROSS JURISDICTIONS



Bubble size represents absolute covered total greenhouse gas emissions.

*For CPIs that have multiple price levels, the price applying to the larger share of emissions is used.

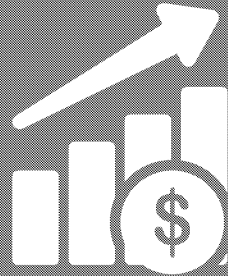
**This is a composite presentation representing total emissions covered by carbon pricing instruments under the Pan-Canadian Framework. It includes a combination of ETS-like and carbon tax-like instruments, implemented at both provincial and federal levels.

Executive summary



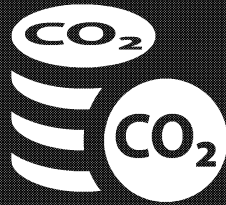
CROSS-BORDER APPROACHES TO CARBON PRICING ARE INCREASINGLY GAINING TRACTION

- The European Union (EU) moved closer to adopting its carbon border adjustment mechanism, and Canada and the United Kingdom are exploring options for similar mechanisms.
- The International Monetary Fund and World Trade Organization are advocating for an international carbon pricing floor.
- Some countries have moved toward the adoption of international climate clubs, including the proposed United States (US)–EU Carbon-Based Sectoral Arrangement on Steel and Aluminum Trade.
- These approaches can fortify domestic support, prevent carbon leakage, and encourage mitigation beyond national borders.



CARBON PRICES HAVE HIT RECORD HIGHS IN MANY JURISDICTIONS

- Record ETS prices were observed in the European Union, California, New Zealand, and Republic of Korea, among other markets, while several carbon taxes also saw prices hit their highest levels yet.
- A combination of policy reforms, anticipated changes, speculative investment interest, and broader economic trends, especially in global energy commodity markets, are driving these ETS price spikes.
- Nonetheless, prices must rise considerably more to meet the Paris Agreement temperature goals, as less than 4% of global emissions are currently covered by a direct carbon price within the range needed by 2030.

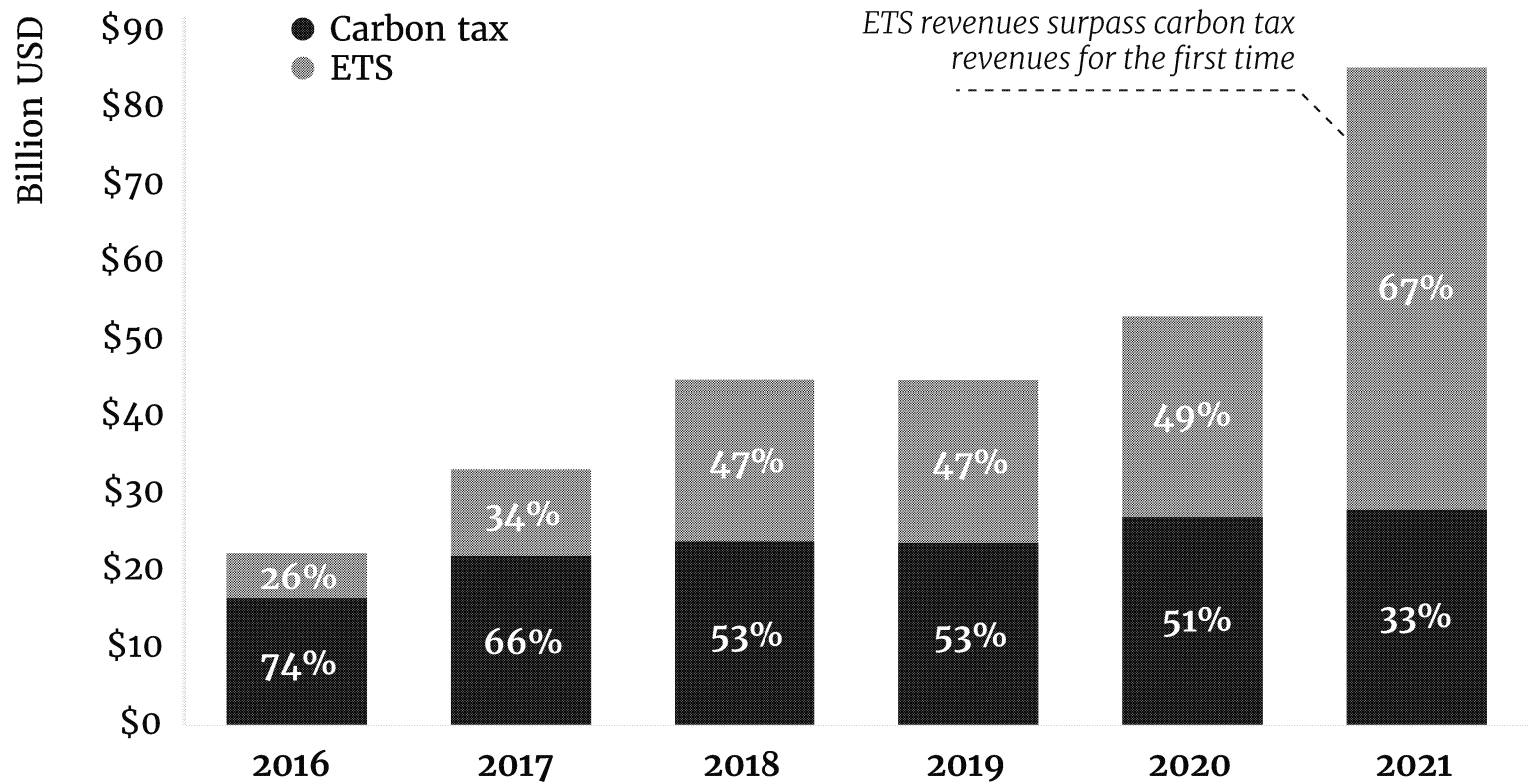


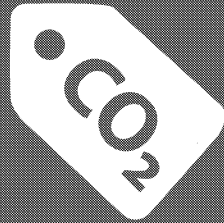
CARBON REVENUES HAVE INCREASED SHARPLY

- Global carbon pricing revenue increased by almost 60% in the past year, to around USD 84 billion.
- With prices rising and reduced free allocation, ETS revenues surpassed carbon tax revenues for the first time.
- Increasing carbon pricing revenues can support sustainable economic recovery, finance broader fiscal reforms, or help buffer countries from economic and international turbulence.

Executive summary

GLOBAL CARBON PRICING REVENUES OVER TIME



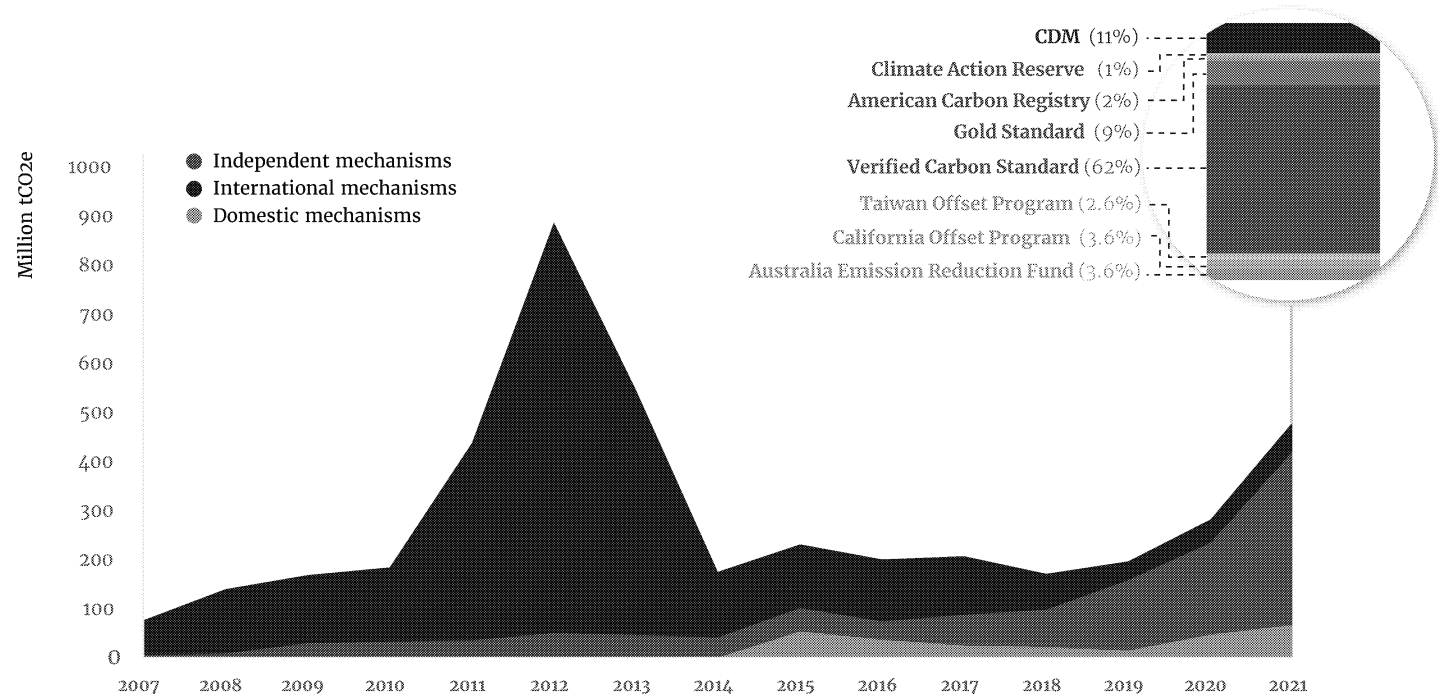


MARKETS FOR CARBON CREDITS ARE GROWING RAPIDLY

- Credits from independent crediting mechanisms clearly dominate the carbon market.
- Annual voluntary carbon market value exceeded USD 1 billion for the first time, driven by corporate commitments.
- Compliance demand for carbon credits remains limited, though new rules for international carbon markets under Article 6 of the Paris Agreement provide clarity that may enable future growth.

Executive summary

GLOBAL VOLUME OF ISSUANCES BY CREDITING MECHANISM CATEGORY

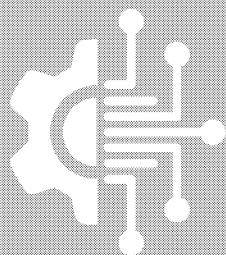




DIVERSE PURCHASER PREFERENCES MAKE MARKET GROWTH UNEVEN

- Nature-based credits are in especially high demand: forestry and land use transactions more than doubled between 2020 and 2021.
- Increasing demand for carbon removals has resulted in price increases for these credits.
- The voluntary carbon market continues to be strongly diverse, with purchasers placing widely different values on characteristics such as sector, geography, and perceived co-benefits.

Executive summary



NEW FINANCIAL SERVICES, TECHNOLOGIES AND GOVERNANCE FRAMEWORKS ARE SHAPING CARBON MARKETS

- Financial actors are becoming more active in the carbon market, while blockchain has enabled a new wave of decentralized financial innovations that show the technology's potential but have reignited some long-standing concerns about transparency and quality.
- Diverse governance frameworks are emerging from stakeholders and institutions that aim to address concerns regarding the integrity of carbon credits and how companies use them.
- New rules on Article 6 increase certainty while also adding complexity to carbon credit markets and may lead to increasingly divergent approaches emerging across actors and geographies.