

TWO COUNTRIES, TWO APPROACHES TO CARBON PRICING

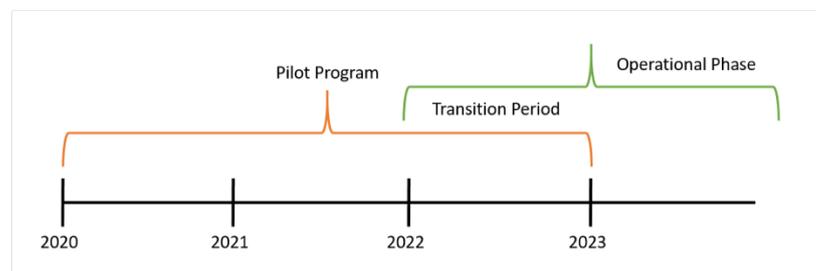
In the era of the Paris Agreement, every participating country will be taking action to cut emissions in a way which best suits its economy. For some, like Mexico, this action will be a continuation of things which were already in motion in 2015, while for others such as Canada, it will be new ideas and approaches developed in the past few years. Below are two profiles of how the national governments of these two North American nations are approaching carbon pricing as they work towards their Paris contributions.

Case Study: Emissions Trading in Mexico; It's Pilot Time

Emissions trading systems (ETS) have proven to be the most efficient and cost-effective way to reduce greenhouse gas emissions. According to a recent study conducted by Thomson Reuters (2018), it is expected that emissions trading will expand throughout the world and a high percentage of the surveyed ETS participants agree that the market instrument compels them to reduce emissions.

In April 2012, the Mexican Congress unanimously

Figure 1: Implementation Phases of the Mexican ETS.



approved the General Law on Climate Change (LGCC by its acronym in Spanish), which was implemented in October of the same year. This marked Mexico as the first developing country to design and implement an

integrated climate change law. In April 2018, the LGCC was revised. One of the most important changes was the modification of Article 94 in which language for the “possible implementation of a Mexican

¹ It should be noted that a first version of these bases was released for public consultation at the end of 2018 but they were withdrawn by the incoming administration to make revisions and corrections.

ETS” was replaced by a decree for its obligatory implementation. The ETS will be implemented gradually and progressively, limiting the exposure of Mexican industry to competitiveness risks facing international markets (Brun, 2019). The amended law was enacted in July 2018, and on 23 May 2019 the government released a draft rule for the pilot emissions trading system¹ for public consultation.

This document establishes that the Mexican ETS will be implemented in two phases: the first one will be referred to as the Pilot Program and it will last 36 months, which includes a one-year transition period towards the Operational Phase (or full implementation).

The following are some of the principle characteristics of the pilot programme:

- Greenhouse gas coverage: Only CO₂ (whereas the Operational Phase will cover all the GHGs included in the General Law on Climate Change).
- Sectoral coverage: Energy and industry, specifically the

following subsectors (see Table 1).

- Emission threshold: Those facilities that in addition to belonging to the aforementioned sectors have annual emissions from stationary sources that match or exceed the threshold of 100,000 tCO₂ will be included in the Mexican ETS. This translates into approximately 308 covered facilities in the whole country.
- Emission coverage: Approximately 45% of national emissions.
- Use of offsets: Offsets can be used for up to 10% of compliance. These offsets will not lose validity between the Test Program and the Operational Phase.
- Allocation method: Grandfathering
- Flexibility mechanisms: Price collar for auctions, market reserves of allowances, and banking (throughout the Test Program).

During the Pilot Phase, non-economic penalties for non-compliance are included to

encourage participation. These penalties include not allowing the monetization of allowances unless the participants fulfill the liabilities (in accordance to the deadlines/established periods), and a reduction of two allowances in the first period of the Operational Phase for each one that the participant does not deliver during the pilot.

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Table 1: Sectoral Coverage

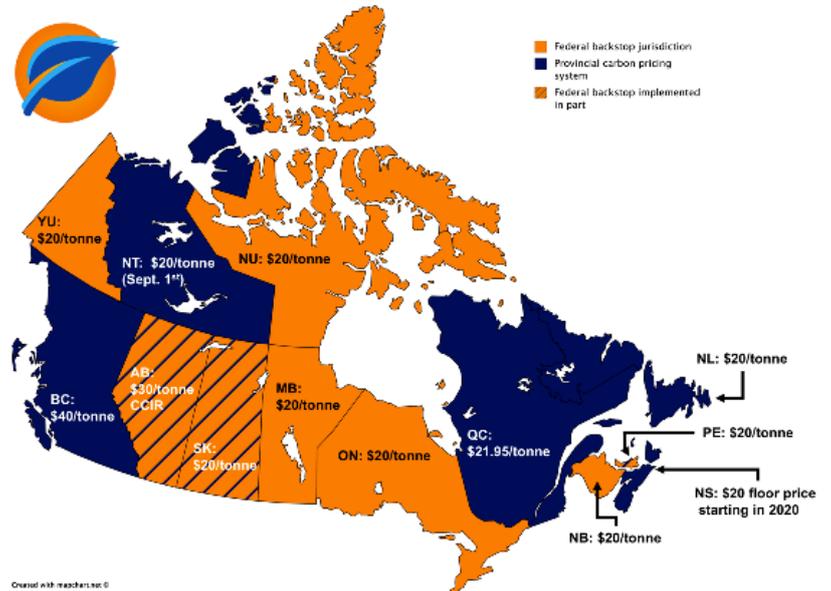
Energy	Industry
<ul style="list-style-type: none"> • Exploitation • Production • Transport • Distribution • Hydrocarbons • Generation • Transmission • Electricity distribution 	<ul style="list-style-type: none"> • Automotive industry • Cement and lime • Chemistry • Food and beverages • Glass • Iron and steel • Metallurgic • Mining • Petrochemistry • Pulp and paper • Other industries that generate emissions from stationary sources

Case Study: Carbon Pricing, Canada-Style

The Canadian Federal Backstop is comprised of a two-tiered system: the Output Based Pricing System (OBPS) and the Carbon Levy. The programme is currently imposed wholly or in part in provinces and territories that did not implement an equivalent carbon pricing programme, as determined by the Federal government. Manitoba, Ontario, New Brunswick, Yukon and Nunavut are Backstop jurisdictions. British Columbia, Quebec, Nova Scotia, Northwest Territories, and Newfoundland and Labrador have their own, federally approved, provincially administered carbon pricing systems. Saskatchewan and Prince Edward Island have province-specific hybrid programmes. Alberta has its own mechanism for large emitters and will have the Levy imposed as of 1 January 2020, as stated by the Federal government.

The carbon levy applies to fossil fuels in backstop jurisdictions. The levy started at C\$20/tonne of CO₂e in 2019 and will increase by C\$10 on 1 April of each year until 2022, when it reaches C\$50/tonne of CO₂e. Under the OBPS stream, industrial facilities with annual emissions of 50,000 tonnes of CO₂e or higher will face a carbon price on the portion of their emissions that are emitted in excess of a specified limit. These emissions limits are based on Output Based Standards (OBS), which are calculated as a percentage of the national average of sector's emissions per unit of production. The OBS vary between sectors and are also based on emissions-intensive, trade-exposed (EITE) measurements. Facilities that emit below their emissions limit will generate surplus credits that can be sold or used for their own compliance obligation.

Figure 2: 2019 Carbon prices across Canada



Compliance for mandatory facilities began as of 1 January 2019. Industrial facilities with emissions of 10,000 tonnes CO₂e or higher can voluntarily participate by opting in to the OBPS.

Compliance options for covered OBPS facilities include any combination of surplus credits, offsets or paying the excess emissions charge which will mirror the levy price. Compliance units, such as offset and surplus credits, represent a lower cost compliance option for covered facilities. Offsets from existing provincial offset programmes, known as Recognized Units, can be used for compliance in the OBPS.

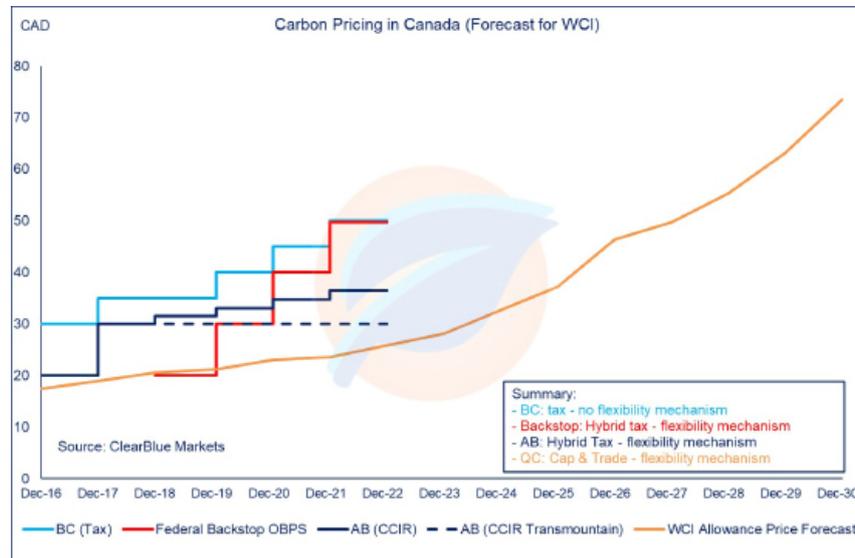
It is expected that credits from agriculture, waste, land use and forestry project types in the BC, Alberta and Quebec's offset programmes will be prioritised. A federal offset programme is currently being developed to increase the supply of offsets available to OBPS participants. Regulated facilities can use offsets to cover 100% of their

compliance obligation in the first three compliance years. The offset usage limit drops to 75% for compliance for 2022.

The Federal Backstop is revenue neutral, meaning the proceeds will be returned to households, industry, institutions, and small and medium sized businesses in the jurisdiction from which they were collected to support climate action. The Federal Backstop will undergo a programme review in 2022.

The constitutional justification for the implementation of the Greenhouse Gas Pricing Pollution Act (GGPPA), which underpins the OBPS and Carbon Levy, is currently being challenged in court. Ontario and Saskatchewan have launched different constitutional challenges, both of which were rejected in their respective Provincial Courts of Appeal, but both have been appealed to the Supreme Court of Canada. Alberta is also launching its own challenge and Manitoba has filed for judicial review of the programme.

Figure 3: Carbon prices in Canada forecast



With the upcoming federal election in October, the continuation of the Federal Backstop system remains uncertain as the Progressive Conservative Party plans to repeal the current system and implement their own plan to reduce emissions, if elected. With a majority government, the Progressive Conservatives would be able to repeal both the carbon levy and OBPS streams of the Federal Backstop. This potential election result will cause uncertainty for regulated entities. However, the Green Party, New Democratic Party and

Liberal Party are all supportive of carbon pricing. Based on their election platforms, the Green Party would remove the OBPS stream to make a one price for all system, while the New Democratic Party would keep the current Federal Backstop with some enhancements. If re-elected the Liberals will keep the current system unchanged. Due to this uncertainty, it is essential for regulated entities to take a proactive approach towards carbon pricing position management.

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