

# Measuring and Maintaining Carbon Markets in Canada

A summary of our feedback to the federal government

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In January 2026, the Pembina Institute commented on Environment and Climate Change Canada's discussion paper, *Driving Effective Carbon Markets in Canada*. Here, we summarize that feedback.

## Recommendations

**Implement annual market-function tests:** Require carbon pricing systems to meet clear outcome-based tests consistent with the federal benchmark—such as maintaining an effective compliance price of at least 75% of the headline price and ensuring sustained net demand for credits— in order to prevent oversupply and preserve a credible price signal.

**Clarify enforcement and backstop triggers:** Establish independent, automatic criteria based on annual compliance price and net demand tests to identify failing systems and trigger timely corrective action or implementation of the federal backstop.

**Protect the carbon price signal:** Exclude mechanisms such as emissions reduction accounts that risk undermining the price signal by weakening credit demand and facilitating double counting.

**Expand and harmonize coverage:** Ensure pricing systems are applied consistently across provinces and include smaller facilities, especially oil and gas, where sectoral emissions coverage gains outweigh administrative costs.

**Improve data transparency and reporting:** Require regular public reporting of credit prices, trading volumes, supply-demand balances, and compliance outcomes, with confidentiality granted only where clearly justified.

Strengthening these elements will ensure that output-based pricing systems (OBPS) across Canada remain fair, effective, and aligned with federal obligations.

The federal government's review process on carbon markets presents a critical opportunity to strengthen industrial carbon pricing systems across the country. With several federal climate policies paused or weakened, **industrial carbon pricing remains one of the most consequential tools available to reduce emissions, attract clean investment, and maintain Canada's climate competitiveness.**

Below, we briefly expand on each of our recommendations.

## Implement annual market-function tests

### *Effective compliance price*

We recommend that systems be required to annually test that their effective compliance price remains within 75% of the headline price (e.g., \$130 at a \$170 headline price) to ensure that the carbon price signal remains sufficiently strong and increases over time. This test would align with commitments made under the November 27, 2025, memorandum of understanding signed between the governments of Canada and Alberta, creating a common standard across systems.

Because the price signal is the primary mechanism for incentivizing decarbonization, assessing equivalency against the effective price faced by firms provides a more direct measure of whether a system is driving the necessary investment in emissions reductions.

### *Net demand for credits*

Net demand tests confirm that demand for credits is outstripping supply, which is important for maintaining a predictable price signal. These tests capture the liquidity of markets and durability of the effective compliance price within a market. They should be required annually, along with the addition of a buffer requirement.

## Clarify enforcement and backstop triggers

It is critical to establish clear, independent criteria to assess system performance against the federal benchmark and to trigger the backstop if those criteria are not met. Determining compliance with these criteria should include tests based on the effective compliance price and net-demand buffer, as mentioned above, which together objectively measure a system's equivalency and market functioning. Applying these tests on an annual basis would enable more timely benchmark assessments and create transparent, robust triggers for implementation of the federal backstop.

## Protect the carbon price signal

Emissions reduction accounts (ERAs) and similar mechanisms, such as Alberta TIER investment credits, undermine market functioning by weakening the price signal and reducing

demand for compliance credits. Designing an ERA framework that preserves credit demand, maintains the integrity of the price signal, and avoids double counting would be complex and difficult to implement without compromising environmental integrity. For this reason, such mechanisms do not align with the current benchmark assessment criteria, and we recommend that this remain the case.

## Expand and harmonize coverage

Clear, consistent coverage requirements across jurisdictions are needed to define covered industrial sources and ensure a level playing field. Moving to an activity-based approach, including small oil and gas facilities, would broaden OBPS market scope by increasing emissions coverage while also addressing interprovincial competitiveness concerns. Given that this could add administrative burden to small emitters, how facilities under common ownership are aggregated for compliance purposes should be explored to help mitigate this impact.

## Improve data transparency and reporting

Data should be public by default. Greater transparency in OBPS markets is essential for establishing investor confidence, ensuring market stability, and supporting effective decision-making. Regulators should be required to publish comprehensive and timely market information to support both compliance planning and independent analysis.