



China Carbon Forum | 中国碳论坛

An independent platform to foster trust and cooperation among China's stakeholders for climate action

China's National ETS: The Way Forward

Executive Summary

On 20th May 2014, China Carbon Forum together with Europe Aid's project team for the "Design and Implementation of Emissions Trading Systems in China" (the EU – China ETS Project) held an event to launch the implementation of the project. The event involved a discussion on "China's National ETS: The Way Forward", which took a forward look at the development of a national emissions trading scheme in China.

The national ETS could become a key component of China's bold ambitions to control its growing carbon emissions and is being watched closely by many other countries and regions that are developing and implementing their own emissions trading systems and carbon market mechanisms.

Record of Discussion

The following is an edited synthesis of discussion that took place at the event among panelists (around 1 hour) and open Q&A with participants (45mins). As per convention, individual's comments are not attributed.

The launch of the EU-ETS project represents important progress in EU-China cooperation on carbon markets. The work plan for the project has involved months of work between the EU team and Chinese counterparts and is now ready to move in to implementation. The project seeks to address China's ETS capacity needs, bringing together the necessary stakeholders. Existing knowledge in the pilot regions is important, but not sufficient. The project hopes to take these lessons to other regions.

The panel emphasized three key points for a well-functioning carbon market. Firstly, cap setting determines scarcity and creates a difference between supply and demand. Putting the cap in to practice is not easy. Those looking for free permits want as many as possible and that must be dealt with carefully by decision makers as the market can be over supplied such as in the EU which has had to attempt to remove some permits from the market.

Second is building the infrastructure for an ETS. This needs to be reliable and transparent. The registry is not often spoken about, but it is the “backbone” of the market, just as with a stock exchange. This includes cyber-security. The EU had a problem with this because of its initial decentralized system, which some took advantage of. This is being rectified in the new period. The third element, trust, has to do with market participants. Monitoring Reporting and Verification (MRV) is important for this. Transparent guidelines, reliable verifiers are important for creating trust between market operators, otherwise they won't participate. EU guidelines involved a lot of work, and have been made available to those involved in ETS development in China.

China is currently in the process of preparing its national ETS. The exact timetable is not entirely clear, however pilots are road-testing the key elements of design for a national ETS. Each pilot is different, in terms of economic and industry structure, meaning that different schemes are testing different rules and approaches. Most are located in eastern and central areas which are more economically developed than the west. However the Clean Development Mechanism (CDM) program has involved many projects in western China, meaning that there is experience of reliable MRV in the west as well. China has strong experience of verification through CDM. Many of the same companies involved in CDM are now involved in verification for the pilot regions.

Strong central government leadership is an asset. Accurate data availability is the main weakness. The National Development and Reform Commissions' (NDRC) national requirements for large companies will help to address this. Looking internationally, one key difference is the legal basis for ETS which most Chinese pilot regions lack. The central government is aware of this and will likely address this for a national ETS. Capacity is a significant issue moving to a national ETS, especially for verification. Another issue is how to deal with national SOEs, a peculiarly Chinese issue. The local DRCs dealing with SOEs may be told that they do not have authority. All of these issues are being considered by the government moving towards a national ETS.

Implementation of the EU-China ETS project will involve three parts: 1) regional training in non-pilot regions, involving various stakeholders and experts, covering the building blocks of ETS; 2) specific

trainings, focused on specific aspects of ETS to advance existing knowledge; 3) meetings with senior experts, to ensure that necessary strategic work is being done for a successful national ETS.

The difference between this project and the work that the World Bank's Partnerships for Market Readiness (PMR) is doing in China is that the EU-ETS project will focus on training and capacity building, which will help ensure a successful national ETS. The PMR programme is working more at the high-level design decision-making process. There is, however, complementarity. The PMR programme aims to help NDRC establish the cap, the coverage, rules, legal framework as well as elements looking at MRV and how to engage particular sectors and provinces. The EU-ETS project is also complementary with work done to establish national sectoral guidelines for MRV, and work on the legal framework, which is currently underway by Chinese experts.

Recent meetings between President Xi and European leaders produced a statement that both parties want to work toward national commitments that will have legal force, whatever that means, and that commitments will be presented well before the Paris COP. This is important because it reflects a "full, mutual" commitment to a binding agreement, and shows that these key parties are not dragging their feet. It also emphasizes "verifiable", which aims to avoid problems with a multitude of transparency standards. The statement reflects European concerns that parties may move toward less-binding commitments at Paris, and that the negotiations will be difficult and it's important that an agreement be more than just a piece of paper. Successful carbon markets, similarly, rely on enforceable legislation. Europe's shift from a decentralized to centralized model could inform China's ETS development, with the same advantages of standardizing of design and regulation.

The panel referred to, and endorsed, the findings of China Carbon Forum's 2013 carbon pricing survey, which found that the majority of experts expected the national ETS to be in operation by the later years of the 13th Five Year Plan. The process of establishing emissions trading is more difficult than expected. There has been discussion in Beijing about how much local air pollution is due to fossil fuels. The current priority for most people is local pollution which has an immediate impact on people's lives. There are clear links between China's war on pollution, and reducing carbon emissions. To that extent, if China cannot address local pollution, it will not solve the climate change issue. Maximising the synergies between these policy areas will be beneficial. Policy measures that address both challenges will have co-benefits. The good news is that the cost of such measures is coming down significantly.

A carbon tax still remains uncertain. The panel emphasized that the key is for decarbonisation to be incentivised. In Europe, the obstacle to carbon taxation has been political. However in the EU, the ETS has proven that it can play the role of providing the incentive. The temporary low prices will be addressed through new legal approaches. The ETS has reduced pollution at least cost.

Hubei's pilot scheme has seen high trading volumes, however it is not clear that this reflects any particular advantage. All pilots are in a process of learning by doing. Once the first compliance cycle has been completed, some meaningful information will be available to analyse what is working and not. In Hubei, there was a low initial price for permits. This likely led to investors buying in anticipation of profit potential. It also reflects access to the market by non-covered entities.

The UK discovered that the wider market, the cheaper the abatement options, which explains its eagerness for participation in the European market. The same dynamic will exist in China, and as markets connect and scale up they will provide more abatement options.

The EU opted for absolute cap-setting, which proved problematic with lower than expected economic growth, while China is largely opting for intensity-based cap setting. The panel was asked about a potential for a unified approach based on intensity-based caps with ambitious benchmarking. Any move towards unification would help address carbon leakage and efforts by industries to protect themselves. Significant linking would be unlikely to happen prior to 2020 however given the Chinese timetable. Also, there are strengths to developing ETSs based on local conditions which ensure their success domestically. This does not preclude mechanisms for linking. The benefit of absolute caps provides simplicity. All players know what needs to be delivered to the ton. Simplicity matters in the market. A hybrid approach may be assisted by a market reserve.

Does the government's existing approach of providing emissions reduction targets to each province provide a barrier to cross-provincial trading and achieving truly least-cost abatement? The panel suggested that this issue is currently under discussion internally, and that there is a feeling that a 'top-down' approach may be better than 'bottom-up' provincial targets. This challenge is also reflected in Europe with 28 separate countries. In Europe, only sectors outside of the ETS are subject to specific national targets. China's pilots have pursued a different approach to Europe in relation to indirect emissions. That is partly because China's pilot regions have a significant volume of imported electricity. It is also because of China's unique energy sector. In addition, other policies need to be considered for their complementarity and/or conflict with the ETS.