RENATO ROLDAO

CHINA'S NATIONAL ETS: IT'S NOT HOW IT STARTS, BUT HOW IT ENDS

China has announced it intends to start a national emissions trading system, known as the China ETS (CETS), in 2017.

The entire country will embark on a fast-paced learning curve in the first phase, that is expected to produce a refined, improved and innovative ETS design towards the end of the decade (2019-2020), when preparations are finalised for the second phase.

CETS will also be a test of emissions trading on an unprecedented scale. China will bring together the relevant lessons and experiences learnt in the seven pilot markets that have operated since 2013, and will build on the series of "dos and don'ts" that have been learned.

This article will shed some light on some of the national ETS' design features and how they might evolve, noting that some of the final design elements are still being elaborated.

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ROADMAP[1] FOR NATIONAL ETS

As the title of this article suggests, for CETS to be successful and achieve its purpose, it will rely on a clear vision, strong leadership and, critically, coordination by the climate change department of China's National Development and Reform Commission (NDRC). This body will work closely with 20 other ministries and government departments, representatives of over 18 industry sectors as well as other stakeholders.

In order to develop its top-down approach in good time, China began drafting its roadmap for a nationwide ETS at the same time as the seven pilot markets were being launched. Through this process the 31 provincial level authorities are already preparing their implementation plans that will guarantee the roll-out of CETS across the country in a consistent manner. The roadmap highlights different roles and responsibilities for the central government, local government and industries, among other key stakeholders, and it is in line with what is expected to emerge in legislation for the CETS, to be released soon by the State Council.

The legislative framework for CETS should build upon the "Interim Management Rules on Emissions Trading"[2] published in December 2014 by (NDRC) and also the Notice #57 on "the Key Tasks for the Launch of the National Carbon Trading Market"[3] from January 11, 2016.

HARMONIZED COMPLIANCE RULES ACROSS THE COUNTRY

The CETS compliance process will be a two-level management system with the central government and provincial governments having different roles and responsibilities. Central government will be in charge of rule setting, coverage and scope, allocation approaches, monitoring and reporting guidelines and standards, verification standards, offsetting, transaction and market oversight rules.

Provincial-level government will be in charge of: implementation rules, identification and direct communication with covered entities, and assessment of compliance and approval of monitoring plans; this will be compulsory from the start of the national ETS. A set of comprehensive compliance rules should include financial penalties, restriction of access to credit and/or ineligibility for any preferential policies and incentives for those installations that default.

ALLOCATION AND CAP-SETTING

Of the several possible allocation approaches, CETS will start mainly with grandfathering, before moving gradually to benchmarking and an increased percentage of auctioning. This will evolve taking into account China's present and future economic situation. It is a balancing act where unified allocation rules are applied but also take into account the need to address regional disparities and to reduce excessive industrial capacity, while avoiding over-allocation.

Despite the unified rules, there will be some flexibility given to provinces that can extend coverage and scope or apply stricter allocation approaches that will allow them to achieve faster higher emission reduction targets.

To mitigate the risk of oversupply that has hampered the European Union's ETS for many years China will base its first allocation on "historic intensity", which combines actual production data with historical emissions intensity plus an annual reduction factor. In practice the allocation will be done in two steps: pre-allocation according to estimated production data, and an ex-post adjustment.

SECTORS	SUB-SECTORS
PETROCHEMICAL	Crude processing, Ethylene production
CHEMICAL	Chemical raw material / Fertilizer / Pesticide production / Synthetic material
BUILDING MATERIAL	Cement clinker production, Plate glass production
IRON AND STEEL	Crude steel production / Steel rolling
NONFERROUS METAL	Electrolytic Aluminum, Copper smelting
PAPER MAKING	Pulp production, Paper making
POWER	Generation, Cogeneration, Grid
AVIATION	Passenger air transport, Air cargo transport, Airports

Source: NDRC

This can also be combined with some additional flexibility mechanisms, similar to the EU ETS' Market Stability Reserve (MSR), that might be embedded in the CETS design.

The nationwide ETS cap will be determined mainly by the same approach as for allocation, by collecting and aggregating emissions data. First, local Development and Reform Commissions (DRCs) collect data, that are then reported to NDRC. NDRC will then set the national cap, which will then be broken down into provincial level caps and lead to the final allocation to installations.

SECTORAL COVERAGE REVISITED

Over the past several months the NDRC has been refining and reviewing its approach for CETS sectoral coverage. From an initial announcement listing six sectors, the plan has evolved to cover eight sectors and 20 sub-sectors, including companies emitting more than 25,000 metric tons of CO2 equivalent in any year between 2013 and 2015.

Other sectors will be considered by default as non-ETS sectors though it might be possible that they will eventually be subject to a price on carbon through other measures such as a carbon tax.

As has been the experienced in other carbon markets, the sectoral coverage of an ETS is subject to change, with sectors being added or taken away over time. It is naturally important that the future inclusion or exclusion of any given sector is communicated in a way that makes the new regulatory framework predictable.

MONITORING, REPORTING, VERIFICATION AND ACCREDITATION

The monitoring, reporting verification and accreditation (MRVA) system is quickly evolving from the piecemeal approach of the 7 pilot markets into a harmonized system that builds upon 24 sectoral guidelines for monitoring and reporting and national verification guidelines.

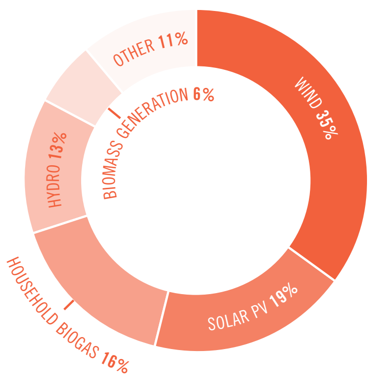
The system will be based on international standards and best practises and will have accreditation rules for independent verifiers. Until now, provincial DRCs selected qualified verifiers and organized reporting and verifications according to their own rules, but as a next step NDRC will announce a list of nationally accredited verifiers that can operate in the market from 2017. At the start, the costs of contracting independent verifiers are expected to be covered by the local DRCs.

USE OF OFFSETS

The national China Certified Emissions Reductions (CCER) system builds on the experience accumulated in China with the UNFCCC's Clean Development Mechanism (CDM). The CCER system has been operating for more than three years, supporting the offset markets of the pilot systems. It is the only type of offset that will be eligible at the start of CETS. Wind power, solar PV, hydropower and household biogas are the most popular project types. The regulatory system for the Chinese offset market is being upgraded in order to avoid an excess of offsets harming the national market.

Renato Roldao *is Consulting Director at ICF in Beijing.*

ISSUED CCER BY PROJECT NUMBERS



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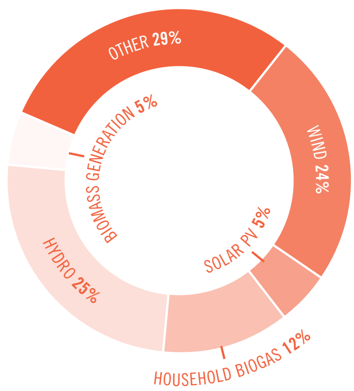

Source: NDRC.

(1) Maosheng, Duan, From Carbon Emissions Trading Pilots to National System: The Road Map for China, Carbon & Climate Law Review, Volume 9 (2015), Issue 3, Pages 231 – 242, viewed 6th October, 2016, http://cclr.lexxion.eu/article/CCLR/2015/3/7 (2) Chinese version available here http://qhs.ndrc.gov.cn/gzdt/201412/t20141212_652035.html (3) Chinese version available here http://www.gov.cn/xinwen/2016-01/22/content_5035432.htm