Governance of China's National Carbon Market

Leveraging Finance for Green Policy Briefs

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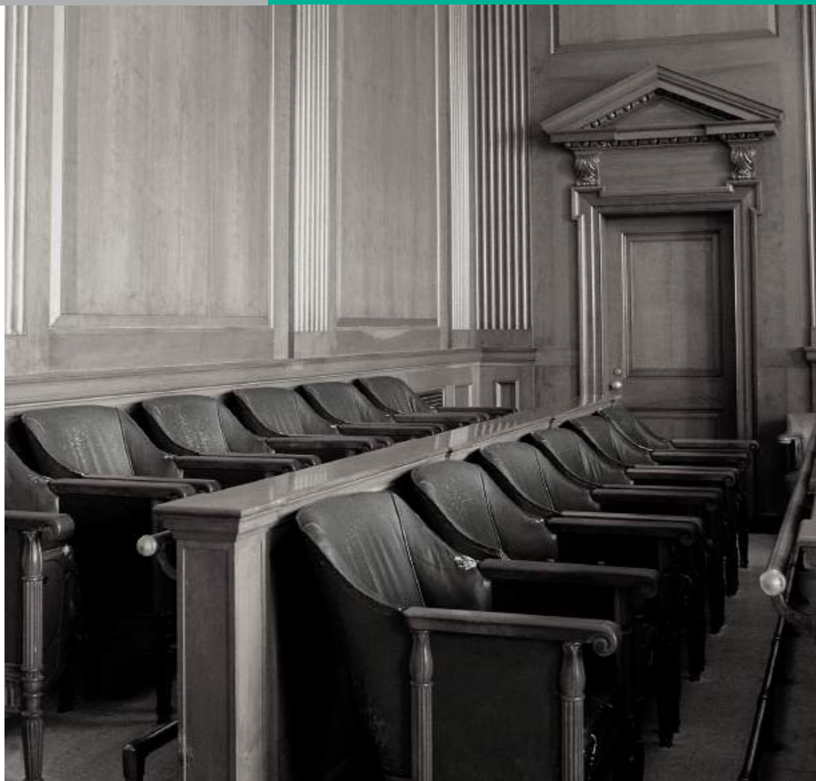

EXECUTIVE SUMMARY

China's national carbon market, also known as its emission trading system (ETS), was launched in December 2017 and is the centerpiece of China's climate mitigation policies. It is both an environmental policy tool and an artificial financial market with dual objectives—to achieve an environmental target and to do so at cost-effective levels. In any financial market or in any design of an effective environmental policy, a clear governance system is essential to ensure proper implementation and enforcement, and to create incentives for compliance and risk certainty for long-term strategies.

An ETS governance system must be overseen by a high-level central government entity with the legal mandate to authorize and implement a regulatory agenda for market operations, monitoring, reporting, and verification (MRV) systems, and for compliance assessment. It should also provide strategic guidance for continued development of the national market and implement robust regulatory processes for governance of the national ETS, which would effectively be the basis for carbon price-setting. Together, standardized guidelines and infrastructure at the central government level should provide the foundation for ETS work at the regional and local levels.

Currently, the governance of China's national ETS is in the hands of the newly established Ministry of Ecology and Environment's (MEE) Department of Climate Change, formerly housed within the National Development and Reform Commission. In order for China's ETS to be effective, MEE regulators must coordinate not only with sub-national governments, but also with central financial regulators to set broader market policies, trading regulations, and oversight of carbon trade exchanges. In addition, the range of stakeholders and interests are broad and should be accounted for in the design of an effective national ETS governance for China.

In this early phase of ETS development, it is prime time to offer counsel for consideration. In light of global and regional carbon market experiences, the following recommendations are proposed to help guide the development of the governance structure for China's ETS.

- Establish a high-level working group reporting directly to the State Council to have primary responsibility for carbon market design, to facilitate cross-ministry dialogue and decisions, and to maintain policy cohesion between carbon markets and other political and economic agendas.
- Engage with stakeholders to ensure buy-in. This includes external outreach to industry and sector organizations, regional climate and environment agencies, and other environmental, energy and economic policy makers, and internal connections with other regulatory agencies.
- Leverage existing infrastructure to provide a strong foundation for the ETS. This would include adding carbon allowances as another type of permit in the current platform for the pollutant emission permitting system in the MEE's Department of Environmental Impact. The environmental enforcement functions in place under the Environmental Protection Law could be engaged for compliance.
- Establish a multidisciplinary task force to provide independent opinions and recommendations and to facilitate timely adjustments to the ETS.
- Emphasize transparency to promote confidence in the ETS. National ETS risk evaluations should be conducted to effectively design supportive financial regulations.
- Establish a national carbon trading system to realize fair exchanges and transparent prices and to put a price on carbon for market players.

These recommendations are not an exhaustive list and should be considered as a starting point for debate and experimentation. Governance is just one part of the equation for the design of China's national ETS, yet it is a key structural component for success.