

Key Issues in Designing China's National Carbon Emissions Trading System

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Executive summary

China is now finalizing the design for a national carbon emissions trading system, which is set to be launched in 2017. The design of the national system has differed in many respects from existing systems such as the EU ETS, including the provisions of the legal framework, coverage and scope, allocation, cap setting, monitoring, reporting and verification, compliance, and division of responsibilities. Such differences are due above all to the special circumstances in which China's national system will operate, for example, significant development differences between the eastern, central, and western regions of China, concerns about the possible impacts of the system on the economy expressed not only by industries but also by some authorities, and in parallel, implementation of related reforms such as the power sector reform.

The most serious challenge in the design process is how to effectively address these issues while at the same time ensuring high efficiency and effectiveness of the system and maintaining unified rules across the whole system. To address regional disparities, the provinces have been allowed to extend the coverage and scope of the national system within their jurisdictions and to use stricter free allocation approaches that will not jeopardize the environmental integrity of the system. Regional differences in technology have also been considered in the definition of sub-sectors.

In China's national system, real production instead of historical production will be utilized for free allocation under intensity-based approaches in response to the great uncertainties regarding the development of the covered sectors, whereas the emissions cap will be determined mainly using the bottom-up approach. To address the concerns of the covered industries, stakeholder consultations have been conducted through various means and at different levels, and industries have been closely involved in the benchmarking process, with a firewall established to prevent possible conflicts of interest. Comprehensive compliance rules including not only financial penalties but also other measures such as a credit system will be established to facilitate the compliance of all market participants.

Currently, many reforms that are closely connected to and affect both the efficiency and effectiveness of the national system, such as trading of rights to use energy and power sector reform, are happening simultaneously. To make the system adaptable to possible future changes

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in the policy environment, the national system should focus on key targets, and the design, especially the legal basis guiding it, should be flexible enough to avoid unnecessary changes in the near future.

To ensure a unified national system and to maintain necessary incentives for the participation of local authorities, in the design of China's national system, all of the responsibilities that could significantly affect the unification of the national system will be performed by the national authority, and other responsibilities will be assigned to the provincial-level authorities. The national authority is therefore responsible mainly for the formulation of rules and the provincial-level authorities for implementation of the rules.

After the system is launched, it will be crucial to work quickly to effectively coordinate the design of ETS and other closely connected policies, paving the way for future design improvements. When the performance of the national system in its initial stage is reviewed, it will be important to avoid directly adopting indicators from other systems and to keep in mind the special circumstances in which China's national system was developed and has been operating.