



# China launches national emissions trading scheme (ETS)

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The long-awaited world's largest emissions trading scheme (ETS), the Chinese national ETS, was launched on Tuesday 19 December. The National Development and Reform Commission (NDRC) announced it in Beijing following a closed-door conference gathering all relevant ministries and local DRCs. With the announcement the Chinese government delivered on its promise to launch a national carbon market this year. However, no specific details or surprising new information were given on the set-up of the scheme. The lack of any timelines for developments makes a proper start of the ETS within the next year very unlikely.

## The announcement

- China's launch of its national ETS was announced on Tuesday in Beijing.
- Before, the *Carbon Emissions Trading Scheme Construction Plan (for Power Sector)* had been approved by the State Council and released by the NDRC, which marked the official launch of the Chinese National ETS. The plan has not been made publicly available.

## What we know

- **Market size and coverage:** At the beginning, the Chinese ETS will cover only one sector – power. All power plants with annual carbon emissions higher than 26,000 tonnes/year will be covered. Based on the NDRC's calculation, over 1,700 power plants will be included in the scheme, covering over 3bn tonnes/year of emissions. This will make China's the biggest ETS in the world.
- **Three-phase implementation:** The official launch of the Chinese ETS is not equivalent to the start of trading, it is more of a start of the implementation of the system. According to the plans of NDRC, the establishment of the Chinese ETS will be implemented in three phases, with the first two phases focusing on the infrastructure construction and system testing, and the actual trading would happen only in the third phase. There are no details published on the expected timeline.
- **Infrastructure:** Hubei and Shanghai will lead the infrastructure construction of registry and trading system respectively, with joint efforts from some other regional markets/governments.
- **Legislation:** There will be one central interim regulation (to be issued by the central government), and three supplementary measures (focusing on compliance companies, trading and the MRV process) that govern the National ETS. However, no details were released regarding the expected timeline.
- **Allocations:** At the beginning of the National ETS, allocation will "not be very tight". According to previously released allocation guidelines, a benchmarking method will be applied for the power sector.
- **Pilot markets will continue:** All seven pilot markets and Fujian regional markets will continue activity, but sectors covered in the national ETS will not face compliance obligations in the pilots.



- **Developments are planned:** The Chinese government made it clear that developments of the national ETS are planned over the next few years. There was no clear timeline given for any of the points below.
  - Inclusion of new sectors: it was expected earlier this year that the scheme in China would cover up to eight different sectors, including energy intensive sectors such as cement and steel. It is now expected that they will be covered only at a later stage. Among the industrial and aviation sectors, cement and aluminium are preferred candidates to be included sooner due to their simpler production process and better quality of historical emissions data.
  - Introduction of offsetting mechanism: it is expressed that as the ETS gradually improves, Chinese Certified Emissions Reductions (CCER) will be included in the national market step by step as a supplementary mechanism.

## What we do not know

- **Timelines:** Any details on the timelines around the three implementation phases; other next steps are not confirmed.
- **Compliance year:** Due to the uncertainties of implementation timelines, it is not clear when the first compliance cycle will start. This has a significant impact on the pilots as it is still unclear whether the power sectors will be included in their 2017 compliance.
- **Trading regulation:** It is still possible that only compliance companies will be allowed to trade on the exchange at the beginning. If institutional investors are not allowed to directly participate in the market, liquidity could be significantly impacted. However, we expect the institutional investors and financial institutions will finally be allowed to trade in the market when it starts the real trading period.

## What ICIS expects for the market

- The lack of details in the announcement is an indication how little the Chinese government is prepared for a start of the Chinese ETS. It seems as if the announcement was mainly made to deliver on the promise to launch the market in 2017.
- As a result, we do not expect trading to start before 2019. And even then, trading will be dominantly spot and over-the-counter (OTC) trading. The launch of future trading is in discussion for later stages, as the regulators are studying the feasibility of futures products with no specific timeline announced. We estimate the actual trading of futures will happen after 2020.
- There is no clear indication at what level the carbon prices will be in the upcoming ETS. ICIS expects a starting price of around yuan (CNY)40/tonne. Based on experience, there might be some pricing control mechanism such as auction reserves implemented when actual trading commences.
- Regarding trading behaviour, we expect liquidity to concentrate around the compliance date. With only one sector enrolled in the first year, a lot of transactions could happen within individual power groups instead of between them. Most of the trading would therefore be invisible to the wider market which would make a clear price signal from the market less likely.
- The market in its current set-up will likely have a low impact on emissions from Chinese power generation as the free allocation, the benchmarks by generation type and the lack of power trading will not set big incentives to reduce emission for power companies.



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Sisi leads the China Carbon Team for ICIS, which covers the pilot markets in China as well as the upcoming National ETS.

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