China Emission Trading Experiment Unlikely to Ease Cities' Smog

By Benjamin Haas - Jun 17, 2013 6:00 PM ET

China's plan to set up markets to trade emissions will make it second only to Europe in efforts to put a price on pumping carbon into the atmosphere. For cities choking on the nation's smog, expect little relief.

Seven pilot carbon-trading programs are scheduled to start this year, with the first opening today in Shenzhen, followed by Beijing, Shanghai, Guangdong, Tianjin, Chongqing and Hubei. They are set to regulate 800 million to 1 billion tons of emissions by 2015 in the world's biggest cap-and-trade program after Europe's, according to Bloomberg New Energy Finance.

China's National Development and Reform Commission will oversee emission exchanges in a country that the World Banksays has 16 of the world's most-polluted 20 cities. The commission is better known for setting prices than creating open markets, said Stuart Cerne, managing director at Hong Kong-based environmental business consultant Enecore Carbon.

"The NDRC's measure of success of the pilots is primarily focused on technical aspects of setting up the system, whilst the importance of an active trading environment has not been given as much importance," Cerne said by telephone. "Because of unresolved design and regulatory issues, I don't expect that there will be real trading in the pilots other than annual compliance and government influenced transactions."

The seven pilots agreed to regulate emissions using a cap and trade system, with companies that produce more than their allocation buying permits from companies that emit less. Shenzhen's trading will take place on a purpose-built exchange.

Shanghai Clearinghouse

Shanghai's carbon exchange plans to reduce the supply of carbon permits when prices are low and sell more when they are high "to maintain relatively stable levels," NDRC Vice Chairman Xie Zhenhua, said in an April speech on climate legislation. Xie is China's lead climate negotiator.

Regulations governing transactions in Shenzhen are still being worked on and aren't expected to be released by the start of trading, according to a presentation by the city. Shenzhen, one of China's Special Economic Zones designed to promote market policies, will initially include 635 companies in its cap-and-trade program, Mayor Qin Xu said in April. Those companies discharged 31.7 million tons of greenhouse gasesin 2010, 38 percent of the city's total, according to Bloomberg New Energy Finance.

A separate program to complement cap-and-trade in China was a proposed carbon tax that would be paid by consumers at the pump and on utility bills. With economic growth slowing to 7.7 percent in the first quarter, the carbon tax was put on hold after opposition from businesses and local governments.

Taxing Issue

The tax won't be introduced this year amid "obvious opposition," Jia Kang, head of research at the Ministry of Finance, said at parliament's annual session in March.

Kang quoted an initial levy of 5 yuan to 10 yuan (81 cents to $1.62). Starting at that level is too low to make an impact or even meet official targets, according to research from Tsinghua University and China's Central Compilation & Translation Bureau. The effect may be further muted since the government already sets prices for gasoline and electricity that are below market rates.

The goal of the trial markets is to provide know-how to establish a national trading platform, so getting the pilot programs right is important for the political will to tackle pollution in the future, said Cerne at Enecore Carbon, which has offices in Beijing.

EU Assistance

The European Commission, the EU regulator, signed a 25 million euro ($33 million) financing agreement in September 2012 to help set up China's pilot emissions program. "This is an important step for an ever-closer cooperation towards a robust international carbon market and low-carbon development," Isaac Valero-Ladron, climate spokesman for the European Commission, said in an e-mail. "This is a huge opportunity to modernize our economies, stimulate growth and create jobs in new dynamic industries with innovative technologies and clean energy."

While China's western provinces lag behind the east in terms of wealth and development, emission trading has the potential to stifle growth, said Ge Xing'an, vice president at theShenzhen Emissions Exchange. Trading may find less political support in poorer areas looking to attract investment.

"While Shenzhen and Shanghai will meet deadlines, a place like Chongqing might lag behind," Ge said. "While that's not a major problem in the pilot phase, it may become a concern for the national plan."

Non-Compliance

The penalties for non-compliance with the new emissions program may be too low to pose a real threat, according to the Center for Clean Air Policy Europe Director Tomas Wyns, who consulted on Hubei's carbon market design. If profits outweigh the cost of flouting the law, companies have no incentive to reduce pollution. Concern of official corruption is also on the minds of regulators.

"We set up electronic systems to assign quotas to the industries," Wu Delin, vice secretary general for the Shenzhen Municipal Government, said at a press conference in March. "This can help prevent illegal behavior of officials during the assigning of quotas."

Beijing's worst-recorded air pollution earlier this year renewed pressure on the government, which aims to cut carbon emissions by as much as 45 percent before 2020. China's emissions from energy use rose 6 percent last year to 27 percent of the world's total, according to statistics published June 12 by BP Plc. (BP/) That pace is less than 9 percent last year and is the lowest increase since 2008.

Establishing carbon trading in China will be a herculean task given that the country's markets are still immature, Jeff Huang, co-chair of the China working group at the International Emissions Trading Association, said in a telephone interview.

China faces "a unique challenge internationalizing and upgrading their commodity markets overall, while at the same time launching a new market for carbon, something you can't see or touch," Huang said.

To contact the reporter on this story: Benjamin Haas in Hong Kong at bhaas7@bloomberg.net

To contact the editor responsible for this story: Peter Langan at plangan@bloomberg.net