

Dialogue Facility on ETS Development in Asia The Policymaking Process

Meeting Summary

Overview

The Asia Society Policy Institute is convening a series of private dialogue meetings that will bring together experts in emissions trading system (ETS) development from select Asian jurisdictions. The participants will share experiences, challenges, and solutions for successfully designing and implementing national ETSSs, while also building foundations for future market connectivity at Asian and international levels.

The first of these dialogue meetings, held on September 2–3, 2020, by videoconference, focused on policymaking processes relating to ETS development. These processes include but are not limited to gaining high-level political support, gaining necessary levels of buy-in from affected industries and support from government departments, facilitating effective and informed decision-making on ETS design, and determining the optimal role of ETSSs in the policy mix. Related to these processes is capacity building for policymakers, competent authorities, third-party verifiers and covered entities.

These imperatives variously intersect with and exist independently of core ETS design and operationalization issues, which will be focused on further in subsequent dialogue meetings.

The following topics were covered in the meeting:

- Policy development processes
 - Asian and international case studies on engagement with top policymakers and industry to introduce and develop an ETS and decision-making on ETS design and capacity building
 - China
 - Korea
 - EU
 - California
 - New Zealand
 - Policy development challenges across other jurisdictions
 - Japan
 - Thailand
 - Taiwan
 - Indonesia
 - Philippines
- ETS interaction with other policy instruments
 - Asian case studies on determining the role of an ETS in the overall policy mix; intersections, complementarities, and overlaps with other policies; and engagement with other relevant government departments
 - China
 - Korea
 - Policy interaction challenges across other jurisdictions
 - Japan

- Thailand
- Taiwan
- Philippines

The detailed meeting agenda is given in Annex 1.

Participants included policymakers, supporting officials, and experts directly involved in the design and implementation of ETSs in Asia and internationally.

Summary

Cultivating high-level political will for introducing an ETS and gaining buy-in from affected industries

In China, there was political engagement at top decision-making levels from the early stage. A comprehensive program of engagement across all major stakeholders was undertaken at different stages in the policymaking process and continues into the present. Throughout its ETS evolution, China has focused on learning by doing: developing pilot systems to experiment with different design approaches and constantly building capacities across the system.

In Korea, strong political will and leadership marked early stages of ETS development, with ownership of the policy by the head of state leading to cross-cutting buy-in for greenhouse gas (GHG) emission reduction targets. These targets seek to shift the country from business-as-usual emissions to a “business-as-wanted” paradigm and are part of a wider green growth push that has now spanned multiple administrations. To avoid rollback resulting from changes in personnel and administrations, Korea institutionalized climate policies – including the ETS – and the processes for managing and evolving them. Resulting committees have representation across multiple ministries and executive government bodies and include national experts; they have proven robust in the face of political change. Framing the ETS as a long-term business opportunity, closely working with the business community, listening to industry concerns, and reflecting these concerns in the policy design led to needed industry buy-in. Gaining support from other government ministries was likewise important and continues to require diverse and targeted ways to make progress.

In California, statewide commitments to reduce GHG emissions emerged from the governor’s office in 2006, and the ETS was identified as clearly the most cost-effective policy. While opposition from industry and various levels of government was substantial, the policy was successfully introduced through including industry and civil society early in the process to design the system, a transparent approach to engagement and decision-making, extensive stakeholder engagement, and coalition building.

Significant objections to introducing an ETS across multiple jurisdictions stem from competitiveness concerns and doubts about whether such a policy can support long-term economic growth. Price impacts on consumers likewise present challenges, which were recognized as key issues by multiple participants during the discussion. Responding to these concerns with detailed assessments of impacts on competitiveness and economic outcomes is important. These assessments should reflect the evolving climate policy landscape in trading partners and the increasing economic disadvantages of inadequate climate action, as more ambitious jurisdictions seek to protect their industry with measures such as the proposed EU

Carbon Border Adjustment Mechanism (CBAM).¹ It should be recognized that risks of negative competitive impacts can be addressed by carbon leakage protection measures, such as free allocation, which can be important in the initial phases to help gain industry buy-in.

For particular national examples, Korea's lessons about competitiveness impacts of ETSs may be particularly relevant to jurisdictions like Japan, due to Korea's similar industry structure and emissions profile. Thailand is seeking to address industry resistance by providing incentives for business such as support with mitigation options.

The EU was not immune from challenges of building and maintaining industry support. Industrial support wavered as carbon prices stagnated at low levels, leading to the belief that these prices were inadequate for incentivizing investment – despite the EU ETS assurance that GHG emission targets would be met. The Market Stability Reserve (MSR) addressed the low-carbon price, and an Innovation Fund was developed as an important element of the policy to sustain support from industry.

Facilitating effective and informed policy decision-making on ETS design

China's experiences reveal key pathways for facilitating effective and informed decision-making: cultivate independent research that addresses issues of interest to the ETS authorities rather than simply justifying their decisions; identify and assess options (pros and cons); educate regulators so they understand the issues well and can make informed decisions; and involve all relevant stakeholders to build more comprehensive, systematic, and unbiased views. Details were provided on building the necessary capacity for introducing the ETS, and the importance of the availability and quality of data was highlighted as a key issue.

Korea found during early phases of its ETS development that there was a deficit of national-level experience and expertise, which it sought to address through creating and deepening international partnerships with experts and practitioners from more established ETS jurisdictions. As its own capacity and experience grew, Korea established an independent and permanent research center (the Greenhouse Gas Inventory and Research Center, GIR). The GIR provides high-quality GHG inventory data; modeling; and other services to support ETS design, introduction, and implementation; it also provides the necessary continuity and depth of expertise that are more difficult to achieve at the ministry level.

California applies a formal and systematic decision-making process including cost-benefit analyses. Robust data and data verification practices provide the foundation for its system, which complement comprehensive capacity-building efforts for both internal and external stakeholders.

New Zealand has put its ETS on a solid footing by establishing a Climate Change Commission to depoliticize the policymaking process, lending it durability in the face of political changes. This committee was modeled on the UK's Committee on Climate Change, demonstrating the value of learning from other jurisdictions.

¹ Available at https://ec.europa.eu/info/files/carbon-border-adjustment-mechanism_en. The EU's proposed CBAM will put a carbon price on imports of a targeted selection of products with the aim of ensuring that ambitious climate action in the EU does not lead to carbon leakage. If a covered product or material is imported into the EU from a country where there is no similar carbon pricing, a price for the 'embedded emissions' of that good would have to be paid upon import. There would be a gradual phase out of free allocation in the EU-ETS with industry moving to full auctioning. A credible and equivalent carbon price would be necessary to avoid penalties under the CBAM.

As the EU is the most established ETS represented in the discussion, its experience highlights the importance of balancing flexibility and predictability. External factors require authorities to remain flexible, such as the EU ETS's need for the MSR, and to avoid being dogmatic about maintaining what it may see as ideal design and management practices. However, endless flexibility weakens the market and erodes predictability. The EU has achieved predictability through developing and maintaining a clear long-term strategy (net-zero emissions for 2050 and ambitions for 2030) and direction of travel. These policies create market signals that can dampen potentially high levels of short-term volatility and uncertainty. For example, during the worst part of the COVID-19 crisis, the carbon price drop was very short term and quickly returned to its former level. The strong legal foundation provided by the EU ETS Directive has also proven vital for providing a stable core framework for policy development, including clear mandates for how benchmarks should be derived and how auctioning should be done, as well as other key design decisions.

Further potential solutions to challenges of data inadequacies, designing an effective and efficient institutional framework, and building capacity of experts are addressed in the case study presentations and are covered in briefing papers on introducing Chinese and Korean ETSs, which were provided in advance of the meeting.

The role of an ETS in the policy mix and policy interactions

The case studies identified that the ETS is a key GHG emission reduction policy in the respective jurisdictions, with a key role in implementing Nationally Determined Contributions (NDCs) as well as, in the longer term, meeting net-zero emission targets. The fact that an ETS cap guarantees achievement of an emission reduction target is an important benefit to policymakers.

In China, the ETS is intended to become the primary carbon pricing policy and to help strengthen the country's overall climate change policy framework and level of ambition. In the near term, some overlap with other policies exists but can be beneficial in the move toward stronger policies. The ETS will ultimately provide advantages over energy policies that rely on subsidies (which have historically dominated yet are not cost-effective) and command-and-control policies such as energy performance standards (which suffer from inadequate monitoring, reporting and verification, and insufficient punishment for noncompliance).

For the Philippines, the ETS seeks to provide a mechanism for the international transfer of carbon credits under the Paris Agreement. By searching for opportunities for international mitigation collaboration, the Philippines could create more ambitious climate mitigation targets alongside more resilient domestic energy and environmental management systems.

Japan continues to assess whether an ETS is really needed, considering other existing policies. For the power sector, the ETS could play a valuable role in reducing coal power by making it more expensive and promoting fuel switching to gas and renewables (which the current Feed-in-Tariff policy for renewable energy does not do and is plagued by high costs) and by encouraging improved energy efficiency in the industry sector (in line with experience from Tokyo's ETS). The relative cost-effectiveness of alternative policies in GHG mitigation should clearly also be considered, however, giving prominence to the most cost-effective policies and avoiding unnecessary overlap (such as double burden).

In this vein, it is important to prevent double incentives for renewable energy projects, for example, ensuring that both Renewable Energy Certificates (from a Renewable Portfolio Standard policy) and offset credits (usable in an ETS) are not generated by the same project.

Under Phase 3 of the K-ETS, only domestic offsets that go beyond non-ETS policy targets would be allowed.

In China, a potential approach to addressing interaction with renewable energy policies is to expand the coverage of the ETS to include renewable energy installations. A specific challenge in China relates to potential overlaps between the ETS and energy rights trading. However, the ETS is supported by a higher level of legislation and is therefore more likely to survive and remain in the overall policy mix.

In Taiwan, key considerations for establishing the ETS include determining its role relative to other policies, including the electricity emission factor and energy portfolio targets, as well as how to include the power sector's direct emissions in the ETS cap.

Across jurisdictions, assessing the discrete impact of an ETS on GHG emissions relative to other policies and forces is difficult. While methods are available to do this (for example, using econometric analysis or decomposition analysis), the multiple drivers of emissions create unavoidable complexities and may render policymakers less interested in the precise contributions of different policies than in the achievement of overall targets.

Approaches for passing through carbon costs to electricity prices

For the power sector, mechanisms for passing through carbon costs are important and at times challenging to design and implement. This is the case currently in China, where the future of long-standing efforts to reform the power sector will affect the efficacy of the ETS and impact how it covers (or does not cover) indirect emissions. Korea's heavily regulated electricity prices have similarly necessitated the inclusion of both indirect and direct emissions as an interim measure.²

To more effectively encourage decarbonization of the power sector, Korea is considering a potential environmental merit order system, which would enable the inclusion of carbon costs in power station dispatch decisions and a potential full pass-through of the carbon cost to retail electricity prices. At the present time, it is not yet decided what, if any, policy changes might be made in relation to this.

Other

There was some discussion about the future inclusion of the power sector in the K-ETS following media reports. This relates to concerns from the power sector and the energy ministry about the impact of a single benchmark for the sector in Phase 3 for both coal and gas power stations, thus resulting in an advantage for gas and a disadvantage for coal. This has not yet been decided but has led to further discussion about benchmarking, which will be addressed in more detail in a subsequent dialogue meeting.

² Note that double counting of emission reductions is avoided by taking this approach into account in cap setting.

Annex 1: Agenda

Day One – Engagement, policy design, and capacity building

Session 1: Welcome and introduction		
10 mins	Welcome remarks and introduction	Alistair Ritchie, ASPI
Session 2: Policy development process		
60 mins	2a) Asian and international case studies on engagement with top policymakers and industry to introduce and develop an ETS, decision-making on ETS design, and capacity building. <ul style="list-style-type: none">• China• Korea• California• New Zealand	Duan Maosheng, Tsinghua University Sang-hyup Kim, KAIST Center for Sustainable Development Rajinder Sahota, California Air Resources Board Scott Gulliver, New Zealand Ministry for the Environment
10 mins	Q&A	
10 mins	Break	
25 mins	2b) Policy development challenges across other jurisdictions <ul style="list-style-type: none">• Japan• Thailand• Taiwan• Indonesia• Philippines	Shuichiro Niihara, Ministry of the Environment, Japan Kittisak Prukkanone, Ministry of Natural Resources and Environment, Thailand Robert Shih, YC Consultants Dida Gardera, Coordinating Ministry for Economic Affairs, Indonesia Win Gatchalian, Senate, Philippines
30 mins	2c) Discussion <ul style="list-style-type: none">• Cultivating high-level political will, commitment, and support for introducing an ETS• Facilitating effective policy decision-making on ETS design• Gaining necessary levels of buy-in for the ETS from affected industries	All participants Moderator: Alistair Ritchie, ASPI
30 mins	2d) Lessons <ul style="list-style-type: none">• Practical and specific solutions across jurisdictions	
5 mins	2e) Session summary and expectations for Day Two	Jackson Ewing, Duke University/ASPI

Day Two – Role of ETS and policy interaction

Session 3: Recap of Day One

10 mins Review of key lessons discussed on Day One Alistair Ritchie, ASPI

Session 4: Role of ETS and policy interaction

30 mins 4a) Asian case studies on determining the role of ETS in the overall policy mix and its interaction with other policies and engagement with other relevant government departments

- China Zhang Xiliang, Tsinghua University
- Korea Yongsik Choi, Ministry of Environment, Korea

25 mins 4b) Policy interaction challenges across other jurisdictions

- Japan Shuichiro Niihara, Ministry of the Environment, Japan
- Thailand Kittisak Prukkanone, Ministry of Natural Resources and Environment, Thailand
- Taiwan Robert Shih, YC Consultants
- Philippines Rachel Herrera, Climate Change Commission

10 mins Break

30 mins 4c) Discussion

All participants

- Determining the optimal role of ETS in the policy mix
 - Approaches for optimal interaction with NDC targets, energy policies, carbon taxes, and other policies
 - Approaches for passing through carbon cost to electricity price
- Moderator: Jackson Ewing, Duke University/ASPI

30 mins 4d) Lessons

- Practical and specific solutions across jurisdictions

Session 5: Lessons on policymaking processes from the EU

35 mins

- Engagement with top policymakers, other ministries, and industry

Stefanie Hiesinger, European Commission

- Decision-making on ETS design
- Role of ETS in the overall policy mix and interaction with other policies
- Discussion

Session 6: Closing session

10 mins Meeting summary and expectations for future meetings Alistair Ritchie, ASPI