ASIA 01.10.2019 | Junjie Zhang

China's institutional shake-up

To reconcile rapid economic growth and climate change mitigation, China wants to mainstream environmental protection

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In the 2014 China-US joint announcement on climate change, China promised to peak its greenhouse gas (GHG) emissions around 2030. Later this commitment was cemented in the Paris Agreement signed in 2016. However, China's climate ambition has been shadowed by its dwindling economic growth rate, which declined from 14.23 per cent in 2007 to 6.6 per cent in 2018.

As the world's largest emitter and second largest economy, China is striving to strike a balance between economic growth and climate mitigation. The climate-economy trade-off has become even more tricky in recent years especially as the China-US relation sours. On the one hand, the US withdrawal from the Paris Agreement shakes the foundation of China's climate commitment. On the other hand, the deceleration of economic growth, partly thanks to the ongoing trade war between China and the US, constraints China's capacity to curb its GHG emissions.

China is searching for efficient means to reduce GHG emissions while continuing to grow its economy rapidly. Its climate mitigation efforts are focused on five areas: upgrading industrial structure, cleaning energy mix, improving energy efficiency, reducing non-energy related GHG emissions and increasing carbon sinks. These policies are generally aligned with China's overall economic growth strategy that targets developing new industries such as information technology and renewable energy as well as cutting overcapacities in backward industries such as iron and steel.

China's structural reform

In order to better design and implement its climate policies, China is the

process of streamlining climate regulations through institutional reform. China's climate regulatory regime went through significant shakeup in 2018. The most notable change was the shift of the Climate Change Department from the National Development and Reform Commission (NDRC) to the newly established Ministry of Ecology and Environment (MEE).

The rationale of the reform is to consolidate the regulations of climate change and environmental pollution. Global warming and air pollution originate from many same sources; air pollution control measures — such as improving energy efficiency, switching from coal to renewables and shutting down backward production facilities — will also lead to GHG emission reductions. Therefore, the co-control of GHGs and air pollutants, instead of targeting individual pollutants, can lower the cost of both climate and environmental regulations.

Air quality has become a top priority for the central government since 2013. The tightening air pollution control policy becomes a significant contributor to China's GHG emission reductions. By linking the climate change issue to the air pollution concern, climate policy can also gain more support from local governments since for them air quality has a much higher priority than climate change.

The reform enables the climate regulator to take advantage of many policy instruments at the MEE. In 2017, the MEE established a nation-wide emission permit system to consolidate fragmented environmental regulations. It is becoming the core regulatory tool for the emissions from stationary sources. The emission permit system keeps track of facility-level information about production, emission, and pollution control. Although the system only covers environmental pollutants at this moment, it can be easily adapted to include GHG emissions. Incorporating GHGs in the emission permit system can ensure that GHG emission reductions are measurable, reportable, and verifiable (MRV). In this sense, shifting the GHG regulation from the NDRC to the MEE helps to harmonise climate and environmental management.

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The institutional reform has the potential to expedite climate change legislation. Without a law of climate change, the NDRC tended to use departmental rules to regulate GHG emissions. Because the NDRC has powerful influence on economic and energy matters, the rules are generally followed by other ministries and local governments. In comparison, as a newer and weaker ministry, the MEE is more likely to

advocate the rule of law for climate governance. The MEE has strengthened its power through environmental legislation. A case in point is the revised Environmental Protection Law promulgated in 2015. The new law gave the MEE teeth to dramatically strengthen environmental enforcement. Therefore, the MEE would have more incentive to advocate climate legislation than the NDRC. Should this happen, it will bring China's climate commitment to the next level.

Mainstreaming climate legislation

The ministerial shake-up also re-opens the debate of alternative climate policy instruments. Specifically, whether to use carbon market or carbon tax to regulate GHG emissions is becoming a live topic again. The Climate Change Department in the NDRC era advocated carbon market. It created seven regional carbon market pilots in 2013; it also announced the establishment of national emission trading scheme in 2017. When MEE took over the climate regulatory power, it also inherited regional and national carbon markets. Unlike the NDRC, the MEE has no particular reason to stick to carbon market. Carbon tax should be a viable policy option given that China started environmental tax in 2018. It would be convenient to incorporate GHGs in the existing environmental tax code.

Carbon tax has several advantages over carbon market. In general, carbon tax can provide a more certain price signal to emitters. In China's context, carbon tax requires legislation, which is important to cement China's long-term climate commitment. In addition, carbon tax can prevent local governments from interfering the implementation of national climate regulations. As evidenced in the regional pilots, excessive intervention by local governments can lead to the failure of carbon market. Furthermore, carbon tax can leverage the power of the Ministry of Finance (MOF). The MOF is influential in setting key economic policy agenda. Its involvement can strengthen the compliance and enforcement of climate regulations.

However, the reform of climate regulation also comes with some concerns. The major concern is the weakening linkage between climate change and economic issues. Climate change is not a pure emission problem but also a comprehensive economic problem. As China's macroeconomic and energy regulator, the NDRC can move forward the climate agenda by including it in industrial, investment, and energy

policies. In comparison, the environmental ministry has much less capacity to influence the national agenda of economic development and energy transition. It will be challenging for the MEE to coordinate various ministries that have more power than the environmental ministry.

A related concern is whether the MEE can tackle the economic and financial challenges associated with the regional and national carbon markets. The MEE has the capacity to ensure the MRV of GHG emission reductions, which is the foundation of a functional carbon market. However, carbon market is intrinsically connected with the financial market. The MEE needs to work with other ministries, such as the NDRC and the securities regulator, to make sure that the operation of the emission trading scheme does not create unintended economic and financial consequences.

China's reform of climate regime is overall positive. With the pledge to build 'a community with a shared future for humankind', China is determined to continue its path of low carbon development. Whether China can further move forward its climate agenda hinges on the determination of the top leader, which is influenced by the economic consequence of climate mitigation and the global climate commitment. The new environmental ministry has the right expertise and resources to design and implement climate policies. The 'war against air pollution' which had been declared in 2013 has demonstrated the MEE's capacity to tackle the tough challenge of environmental pollution. Once climate change becomes the top item on its agenda, there is no doubt the MEE can support China's climate ambition.



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