

AUSTRALIA-CHINA AGENDA 2013

Climate Change Policy: An opportunity not to miss

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THE AUSTRALIAN Centre on China in the World engages with the public and policy discussion of relations with the People's Republic of China and the Chinese world. Australia-China Agenda 2013 is our contribution to this important election year and the on-going consideration of the bilateral relationship.

This is a relationship that touches on virtually every aspect of our national life. A mature and beneficial engagement of such breadth and depth requires the leadership and support of government at all levels, as well as public stewardship, media understanding, educational enhancement and the strategic involvement of the business community.

Australia-China exchanges are also profoundly influenced by regional and bilateral relationships. Australia and China trade in goods as well as culture, politics and people, ideas and education, community and personalities.

Australia-China Agenda: 2013 brings to the attention of the public and the media, politicians and specialists some reflections and policy ideas authored by specialists with a professional interest and involvement in the relationship.

—Geremie R. Barmé
Founding Director, CIW

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AUSTRALIAN CENTRE ON
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Australian
National
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2013

JANUARY 一月

FEBRUARY 二月

MARCH 三月

APRIL 四月

MAY 五月

JUNE 六月

JULY 七月

AUGUST 八月

SEPTEMBER 九月

OCTOBER 十月

NOVEMBER 十一月

DECEMBER 十二月

二〇一四年

CLIMATE POLICY is an emerging area of co-operation between Australia and China. The federal government should build on this to maximise the benefits both for policy outcomes and relationship building. Current co-operation should be supported and extended. Further collaboration should be explored in relation to governance of emissions trading. The Australian presence in the Chinese policy discussion should be expanded through an increased representation at the Beijing embassy dedicated to climate policy. Finally, the Australian government should provide a commitment to carbon pricing in the medium to long-term, in order that China not go it alone in the region, and Australia maintain its relevance to the policy discussion in China.

Climate Policy Co-operation Always Win-win

Bilateral relations between Australia and China have been subject to an increasingly partisan political debate in Australia during the last two terms of government. Kevin Rudd's Chinese proficiency seemed to give Labor a clear edge for developing the relationship, however, the Liberal Party has worked hard to characterise the relationship as 'troubled'. In particular, the issues of Chinese Foreign Direct Investment (FDI) in Australia and human rights concerns in Tibet have been used to suggest that bilateral

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relations have worsened during the Rudd-Gillard governments. Climate change has also been an issue seen to divide the two countries in the past, at least in Australian domestic rhetoric. The lack of action in China, it has often been suggested, makes any genuine effort on the part of Australia largely meaningless. On closer examination there is little evidence to suggest a genuine rift on any of these issues, however it is on climate change that the hypothesis of a frosty relationship has clearly been debunked.

China's interest in carbon pricing, mooted for some time, but given life through the implementation of seven carbon trading pilot schemes around the country in 2013, has meant that China has had to learn quickly how to implement effectively an economic instrument that took Europe and Australia many years of debate and consideration.

And it is a lesson they've learnt with Australia's help. Once Australia had endured the tortuous process of designing and legislating an emissions trading scheme (ETS) and moved to the implementation phase, the first co-operative meetings were held between staff from Australia's then-Department of Climate Change and China's National Development and Reform Commission (NDRC) as well as members of the design

teams for the seven Chinese pilot schemes. The co-operation was cemented in July 2013 through funding for joint research on market mechanisms for climate change policy between Australian and Chinese universities.

While considerations of fairness have always shaped China's international approach to climate change and in particular its reluctance to adopt binding obligations, the nature of carbon pricing means that co-operative action is always mutually beneficial. Therefore, this is an area that can be used to deepen the bilateral relationship through ambitious research projects and skill sharing.

China's Transition

Until about 2001, China's economic development was both rapid and increasingly energy and carbon efficient. From that point, however, improvements in the carbon intensity and energy intensity of China's growth stalled and development became browner rather than greener. In response, the later years of the Hu Jintao-Wen Jiabao administration and the first year of the Xi Jinping-Li Keqiang term have seen a marked change in rhetoric about the pre-eminence of GDP as a measure of development. Instead, there is a recognition amongst senior leaders that sustainable growth requires less polluted cities, more efficient energy use, and less dependence on exports, especially given international economic volatility. The Twelfth five-year plan (2011-2015) seeks to give substance to this change by encouraging industrial upgrading and domestic consumption (as opposed to heavy manufacturing and exports). During the previous five-year plan (2006-2010), the central government attempted to curb the worst environmental effects of heavy industry and coal-fired power through regulation and mandatory closure of inefficient facilities. Under the current plan, however, there is greater emphasis on market mechanisms and creating economic incentives to reduce pollution. This makes carbon pricing an important tool in the shift to sustainable development, and if the government's strategy is to maintain popular support, the principle of 'polluter pays' must be given full force.

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The 'How' Just as Important as the 'Why'

There is an ongoing debate in China regarding whether a national carbon tax would be a better approach to pricing carbon than emissions trading. Rumours that the debate stems from a power play between the Ministry of Finance and NDRC have been given credence by public comments in recent months. Whatever decisions are made over the next few years in relation to carbon pricing at the national level, the way in which it is managed and implemented will be important. Central government departments vying for their preferred carbon pricing tool will be less important than provincial government planners in shaping policy. The pilot ETS process already underway in China provides some lessons in this regard.

One of the most important design features of an ETS is the mechanism for allocation of free permits to cover enterprises' liability. In the first two phases of the European Union (EU) ETS, a large number of permits were allocated to enterprises based on self-reported historical emissions data. The system has not worked well and has partially

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contributed to the low price of emissions permits in the ETS. In its third phase, however, the EU developed a system of benchmarks for each industry by which to allocate permits. This approach aims to create greater incentive for improvement by the most polluting installations, and has gained significant interest amongst many of China's pilot ETS regions.

Shenzhen, the first scheme to launch, has opted to allocate quotas using an electronic system based on a 'game theory' model designed by academic advisers, a decision of the Shenzhen Development and Reform Commission. The approach is unique for carbon pricing internationally, and the rationale is that the system will provide greater independence for cap-setting. However, without disclosure of the parameters within which the system operates it is impossible

to assess independently its appropriateness, in terms of either efficiency or fairness. Indeed, while the EU (in its third phase) and Australia have established accessible platforms for examining data relevant to the operation of the ETS, transparency of information is largely lacking in China's pilot regions. At the time of writing, six weeks after the launch of trading in Shenzhen, a list of the companies covered by the scheme has yet to be released.

Many of the other pilot regions are ready to launch their schemes, but are waiting on final approval from the NDRC. The way in which pilot design has been carried out means that differences in objectives between design teams and decision makers is more accentuated than for schemes in other countries. In many pilot regions, the expertise of local carbon exchange platforms has been utilised to develop design options. These platforms have a clear incentive to see schemes created which will encourage a significant level of trading, and therefore a limited level of free permit allocation. Local governments, however, may be worried about competitiveness problems if local companies are forced to purchase a significant amount of permits. Some regions, such as Beijing and Shanghai, which feature a large tertiary industry sector, may be less concerned by competitiveness issues, however provinces like Guangdong and Hubei will have the competitiveness of their local industry at the forefront of their minds. In fact, this author's research suggests that sections of government in some regions are actively seeking not just to cripple the permits market, but to mirror the kind of over-allocation that has plagued the European ETS.

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Australia also experienced an extraordinary level of lobbying in this regard during the ETS design process, and it helped to stop the first attempt at implementing ETS legislation. The difference in Australia is that what powerful vested interests were saying to government behind closed doors, they were also saying loud and clear in the public domain. The Chinese counterparts of these vested interests, usually large state-owned enterprises, do not see any need to engage in public advocacy of their position, but rather can achieve their objectives far more effectively through private lobbying and maintaining close relationships with decision-makers. Whatever the outcome, for the central government's objective of transitioning to a sustainable economy, the process is just as important. Transparency of decision-making must be given priority.

Australia's Choice

There is an ingrained attitude in Australian discourse that our geopolitical weight is so weak that any effort to deal with collective international problems will be insignificant. This tendency also acts as a convenient fallback for those who resist increased

costs for Australian polluters. The reality, however, is that policy-makers and experts in the region pay close attention to many of our policy measures, particularly in relatively new areas such as carbon pricing. Partly due to the existing strong trade relationship, previous co-operative work, and partly because of the limited number of case-studies available, Australia's approach to carbon pricing is of keen interest in Beijing. This should be capitalised on in order to strengthen relationships with various sections of Chinese government as well as policy experts.

In terms of the Australian political debate, a recognition that carbon pricing is an international reality is approaching, either through the electorate endorsing the existing approach of the Labor government, or through an incoming Coalition-led government realising that momentum in the world's two largest economies, the US and China, is toward more co-operation on the issue rather than less. While the repeal of the Australian carbon price would without question be seen as a backward step in the region, and would especially be seen as such in China, there is a recognition even within the Liberal Party that it would be temporary. Former Coalition leader Malcolm Turnbull has repeatedly described the party's current policy as 'short term'.

If a new Coalition government is successful in repealing the carbon price, it is likely that when it is eventually reintroduced (presumably by 2020), it would feature much in common with the current scheme. In part this is because whichever party is in government would undoubtedly call on the extensive work that has gone in to developing the current arrangements, from the 2011 Garnaut Climate Change Review to the

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building of bureaucratic expertise within government, rather than start from scratch. In addition, linking emissions trading schemes is an important part of establishing efficient global effort and lowering cost. The link with the EU, then, would need to be reestablished, and further links with markets such as California and other emerging schemes explored.

Given the reality of carbon pricing occurring in the medium and long-term, it makes sense to build on existing Australian expertise and credibility in the short-term. With China launching seven pilot emissions trading schemes and exploring a national scheme this year, the energy with which Australia pursues collaboration in this area will have a lasting impact.

In summary, climate change policy, and carbon pricing specifically, offers an important opportunity for deepening the bilateral relationship in a way that is co-operative and mutually beneficial. Following the 2013 federal election the Australian Government should:

- Reaffirm Australia's commitment to collaborating with China on climate change policy. The funding provided by the current government for cooperative research between policy experts should receive ongoing support, and opportunities for extending it explored.
- Broaden Australia-China collaboration on carbon pricing from purely technical, to research on governance measures to strengthen transparency. Australia learnt much from the EU ETS in establishing transparent and reliable institutions for emissions trading. The corruption and confusion that plagued the first two phases of the EU ETS have been avoided. Australia could work closely with China to help ensure transparency is maximised as China pursues this complex policy measure.
- Consider establishing a permanent representative or team at the Australian embassy in Beijing to work exclusively on maximising collaborative opportunities. The UK and Germany both have a strong presence of climate-policy experts working in Beijing. Australia, to-date, has relied on ad-hoc occasional delegations of experts travelling between the two countries. A more dedicated focus on climate change at the Australian embassy would boost Australia's presence in the policy discussion within China.
- Ideally the Australian government should make a public commitment to carbon pricing in the medium to long-term. While a coalition government has committed to removing the current scheme, a commitment to the principle of carbon pricing would reassure China that it is not going it alone in the region, and maintain Australia's relevance for Chinese policy-making in this area.

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The Australian Centre on China in the World (CIW), College of Asia & the Pacific (CAP), The Australian National University (ANU) is an initiative of the Commonwealth Government of Australia in collaboration with ANU, a university with the most significant concentration of dedicated Chinese Studies expertise and the publisher of the leading Chinese Studies journals in Australia. CIW is a national research centre that is jointly managed by a body of academics that includes scholars of China at universities in Adelaide, Brisbane, Hobart, Melbourne and Sydney.

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