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ESG Remarks and Proposals at China's NPC

The National People's Congress of China, commonly referred to as the NPC, is the highest national legislative body of the country. The NPC meets in full sessions for approximately two weeks each year and votes on important pieces of legislation and personnel assignments. The meeting also collects legislative proposals submitted by representatives to form the NPC's agenda for the year. During this year's NPC meeting, a number of proposals were submitted centring around the ESG theme, providing us with hints on what might be inked into formal legislation in the future.

Steady Green Transition

In a side-meeting with delegations from main coal producer Inner Mongolia during the NPC, President Xi Jinping stated that the green transition of China should not be detached from the reality of the country's coal-dominated energy structure by "throwing away the (coal) resources before securing enough alternatives." He stressed the importance of adopting a coordinated approach and avoiding a campaign-style movement towards decarbonisation targets.

The power shortages of 2021 sent unexpected shockwaves throughout the Chinese economy and alarmed the country's top policymakers about the challenges of cutting emissions while maintaining a healthy economy. It is also worth noting that in the 2022 Government Work Report delivered by Premier Li Keqiang, the Chinese government broke the tradition of setting a quantitative energy intensity target for the year to allow more flexibility. With the higher-than-expected GDP growth target of 5.5% this year and skyrocketing energy prices globally, it is not surprising that top policymakers guided a more delicate approach to replace coal in the short term. In fact, we have observed this trend building up gradually since 2H2021 as the country relaxed decarbonisation guidelines in power consumption and reopened coal mines.

Carbon Market Liberation

In July 2021, China launched the world's largest carbon market to regulate emissions from its power generation sector. Compared to well-established carbon markets, the Chinese market has significantly lower liquidity and carbon price, providing limited incentives for power generators to reduce emissions. Zhang Yichen, the chairman of CITIC Capital submitted a proposal at the NPC to liberate the carbon market by introducing more market participants and improving related supervision/legislative framework. According to Zhang, although by emission coverage the Chinese ETS (emission trading scheme) is twice larger than that of the EU, the trading volume and transaction amount in China has only been 5% and 1.3% of the EU scheme, respectively, indicating insufficient market participation and a steep discount of Chinese carbon credit prices to European ones.

In his proposal, Zhang suggested introducing financial institutions and other market entities to participate in carbon trading and develop carbon futures and other financial derivatives to enhance trading activity, therefore improving the price discovery function of the carbon market.

At present, the Chinese carbon market is regulated by the Ministry of Ecology and Environment (MEE). Zhang believes that the MEE could collaborate with other ministries and commissions to establish a "Carbon Regulatory Commission" with functions similar to the China Securities Regulatory Commission (CSRC) or the China Banking and Insurance Regulatory Commission (CBIRC). Zhang also proposed to speed up the legislative process of related regulation to guide the development of the carbon market and carbon trading.

Emission Allowances Allocation

Another proposal related to carbon trading was brought to the NPC by Bai Chongen, the Dean of the School of Economics and Management at Tsinghua University. Under the current Chinese carbon market, emission allowances are allocated to power generators free of charge and firms would need to purchase additional carbon credit from the market if they emit more emissions than the initial allocation amount.

Bai believes that there are drawbacks to such an allocation mechanism as power generators are unable to pass the additional cost down to power consumers, which leads to cost pressure on the supply side. In the proposal, he suggested changing the initial allocation method of emission allowances, from free distribution of allowances to power companies to free distribution to electricity consumers. Under this mechanism, consumers could then sell allowances on the carbon market to power generators, incentivizing both power generators and consumers to conserve energy and reduce emissions.

Swappable EV Battery

Li Shufu, the chairman of Geely Holding Group, proposed at the NPC that government authorities, industry associations, and automakers should cooperate to accelerate efforts to promote the construction of electric vehicle battery swapping systems. Li believes that, compared with the traditional charging model, swappable batteries could significantly improve the replenishment efficiency and reduce the cost of EV ownership.

In his proposal, Li suggested accelerating the standardization of swappable batteries and related infrastructure. Specifically, He aims to promote the standardization of swappable battery charging protocols, battery packs and swapping infrastructure so that batteries from different manufacturers could be used for all EV models. In addition, his proposal also includes creating two separate certification systems for EVs and swappable batteries to foster market development.

National Low-carbon Transition Fund

At the NPC meeting, venture capitalist Shen Neil Nanpeng who is the founder of Sequoia Capital China proposed to establish a low-carbon transition fund to leverage more participation of social capital. He suggested that all levels of government should also establish carbon-neutral technology funds based on the local industrial structure to attract more funding. According to estimates from Sequoia Capital, the average annual gap in China's green investment will be RMB 3.8 trillion ($604bn) from 2021 to 2060, totalling RMB 150 trillion ($23.5 trillion) over the next four decades.

In his proposal, Shen repeatedly emphasized the importance of capital in developing low-carbon technology and stated that the commercialization of innovative technologies in the energy sector and energy-intensive sector requires extensive and continuous basic research.

Zero-carbon Industrial Parks

Zhang Lei, the CEO of Envision Technology Group, submitted a proposal at NPC to establish zero-carbon industrial parks in western China, where 80% and 90% of the country's wind and solar energy is produced, respectively. He believes that the western region has the resources to cultivate a green industrial revolution and calls for relocating energy-intensive factories from eastern coastal areas to western regions.

He also noted that due to the lack of definition of zero-carbon industrial park, both internationally and domestically, it is urgent to formulate relevant standards for emission measurement and management at industrial parks.

Conclusion

During the past two weeks of the NPC meeting, we observed a growing interest in ESG topics at China's highest legislative body, particularly on the environmental side to fulfil the country's emission reduction commitments. Remarks from President Xi and Premier Li reaffirmed our previous opinion that the journey towards decarbonisation in China would be full of challenges, sometimes even including temporary scale-backs. Overall, we remain cautiously optimistic about China's efforts in driving its low-carbon transition.