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Challenges to the development of carbon markets in China

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Abstract

China has introduced several pilot emission trading schemes to build the basis for a national scheme. The potential scale of this initiative raises prospects for a regional carbon trading network as a way to further engage other major Asian economies. However, the Chinese carbon markets rest upon a unique political-economic context and institutional environment that are likely to limit their development and viability. This article offers an overview of such structural economic and political constraints. Four main challenges are identified, namely, inadequate domestic demand, limited financial involvement, incomplete regulatory infrastructure, and excessive government intervention. The first two challenges concern economic dimensions and may be partially addressed by the incentives created by the newly introduced emission trading schemes. The other two are more deeply entrenched in the dominant political system

and governing practice. They require fundamental changes to the ways in which the state and the market interact. The success of China's carbon market reform depends crucially on the ability of the ongoing efforts to transform the distorted state-market relationship.

Policy relevance

The burgeoning carbon markets offer opportunities for emissions mitigation at lower costs and enable circulation of a new form of capital, i.e. carbon credits, across borders. China accounts for a gigantic share of global GHG emissions and has the potential to significantly scale up these opportunities. There are clear implications for market developers and participants worldwide, including climate policy makers who attempt to link their emission trading schemes to other schemes, firms who seek to take advantage of the inexpensive carbon offsets generated in developing countries, international financial institutions who endeavour to establish their business in an emerging major carbon market, etc. This article can inform their decisions by identifying key issues that may undermine their ability to achieve these goals. Policy makers and stakeholders will benefit from this analysis, which shows how the Chinese carbon markets operate in ways that may be different from their experience elsewhere.

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