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Japan Energy Newsletter

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1 The Ministry of Economy, Trade and Industry Launched a Study Group for the Establishment of a Carbon Credit Market

On December 8, 2021, the Ministry of Economy, Trade and Industry (METI) announced that it has launched a study group to discuss the deployment of a new carbon pricing mechanism as one of the steps to establish a carbon credit market and as part of Japan's broader goal to achieve a carbon neutral society. The newly established "Study Group on the Proper Use of Carbon Credits for the Realization of a Carbon Neutral Society" recently held its first meeting. The study group plans to hold more meetings to examine various issues around establishing a carbon credit market and the proper utilization of carbon credits in Japan.

1.1 Background and Overview

In October 2020, the Suga Administration declared Japan's goal to realize a carbon-neutral society by 2050 and committed the Japanese government to take the appropriate policy measures and to invest in the private sector to promote innovation. As part of this effort, the METI held seven meetings through its "Study Group on Economic Methods for Realizing Carbon Neutrality Worldwide" from February to August 2021. The study group concluded that the utilization of carbon credits is a key method for promoting CO2 reduction when considering cost efficiency and technological neutrality.¹

Hosted by METI's Environment and Economy Office, the "Study Group on the Proper Use of Carbon Credits for the Realization of a Carbon Neutral Society" is chaired by Toshihide Arimura, a Professor of the Faculty of Political Science and Economics at Waseda University. Other members include representatives from the Central Research Institute of Electric Power Industry (CRIEPI), Inpex Corporation, MUFG Bank, Sumitomo Mitsui Banking Corporation (SMBC), Mitsubishi Corporation, Mitsui & Co. Global Strategic Studies Institute, CDP Worldwide-Japan, and Mitsubishi UFJ Research and Consulting Co. In addition, there are several other governmental agencies participating in the study group as observers, such as the Ministry of the Environment (MOE), the Financial Services Agency (FSA), the Ministry of Agriculture, Forestry and Fisheries (MAFF), the Forestry Agency, the Ministry of Land, Infrastructure, Transport and Tourism (MLIT), the Japan Exchange Group (JPX), and the Tokyo Financial Exchange (TFX).

The main purposes of the study group are to:²

(1) Clarify the policy directions of the utilization of carbon credits

Though the number of companies interested in the use of carbon credits is increasing, the usage methods and impacts of carbon credits are not fully understood. There are various types of carbon credits that have already been created by the government and the private sector in Japan and internationally, but there have been challenges in identifying which carbon credits should be utilized and in what way. To address this issue, the study group will clarify the policy directions of the utilization of carbon credits by understanding the basic background for the proper use of carbon credits.

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https://www.meti.go.jp/shingikai/energy_environment/carbon_neutral_jitsugen/pdf/20210825_2.pdf

² https://www.meti.go.jp/shingikai/energy_environment/carbon_credit/pdf/001_02_00.pdf

(2) Present policy direction of the carbon credit market

The Action Plan of the Growth Strategy³, released on June 18, 2021, by the Japanese government, recommended the promotion of a voluntary, market-based carbon pricing mechanism. However, the transaction volumes and trading prices are unclear, since until now, the carbon credits have mainly been traded through bilateral transactions contracted among two parties in Japan. Therefore, the Strategy highlighted the importance of creating an open, transparent carbon trading market. This study group aims to present the policy direction for creating this market, which could bring in international Environmental, Social, and Governance (ESG) funds and make the market a hub for decarbonization businesses worldwide.

METI's Environment and Economy Office will exchange information and solicit opinions from trading companies, energy firms, financial institutions, and stock exchange operators from now through the spring of 2022. Additional meetings will be held by the Environment and Economic Office on creating a carbon credit market. A final study report is expected to be published by March 2023.⁴

1.2 The Concept of the Carbon Credit Market⁵

The METI presented the concept of a carbon credit market in an interim report published by the "Study Group on Economic Methods for Realizing Carbon Neutrality Worldwide" in August 2021. The report highlighted two major action plans to promote the proper use of carbon credits:

- 1) Create the Carbon Neutral Top League, consisting of leading companies that will take pioneering measures against climate change; and
- 2) Establish a carbon credit market that allows companies to trade their carbon emissions

The Carbon Neutral Top League's members will consist of major leading companies, which will voluntarily set ambitious carbon reduction targets and disclose their progress to the public based on the best practices established by the Task Force on Climate-related Financial Disclosures (TCFD). The League will also benefit the participating companies by enhancing their reputation and attracting ESG funds.

METI also plans to create a carbon credit market that will trade two different types of carbon credits. One will be a company-derived credit that can be bought and sold between the members of the League. When the members of the League achieve their carbon reduction targets, the surplus carbon credits will be certified by the government. The second type will be project-based credits, which are already available in the existing market. This type of credit has already been developed and managed by government agencies such as J-Credit for energy and forest conservation projects and the Joint Crediting Mechanism (JCM) to help developing countries reduce their carbon emissions. Companies that are not members of the league will be able to freely trade this type of carbon credits in the market. Each transaction price in the proposed carbon credit market will be disclosed in order to ensure the transparency of the carbon prices in Japan.

³ <https://www.cas.go.jp/jp/seisaku/seicho/pdf/ap2021.pdf>

⁴ https://www.meti.go.jp/shingikai/energy_environment/carbon_credit/pdf/001_02_00.pdf

⁵ https://www.meti.go.jp/shingikai/energy_environment/carbon_credit/pdf/001_05_00.pdf
<https://www.itmedia.co.jp/smartjapan/articles/2108/12/news051.html>

2 The Ministry of Economy, Trade and Industry Proposed a Revised Policy for the Shutdown of Thermal Power Plants⁶

On December 27, 2021, the Ministry of Economy, Trade and Industry (METI) announced that it has decided on a new policy direction to prevent the excessive shutdown of thermal power plants in order to stabilize the power supply. The announcement was made during the 43rd meeting of the Electricity and Gas Basic Policy Subcommittee.

Based on this new policy, a utility that owns and operates its power plants must notify the METI a few months prior to shutting down a plant. During the process of the shutdown, the utility will also be required to take the appropriate measures to make up for the generation loss associated with the expected shutdown. The policy also encourages utilities to restart their thermal power plants that are already suspended if they would face a power supply shortage.⁷

In recent years, thermal power plants have been closing rapidly due to their lower profitability in competition with expanding renewable energy sources. Unfortunately, utilities have been phasing out their thermal power plants at a higher pace than they have been installing new energy plants, which has led to a tight energy supply in Japan. The energy reserve margins of Tokyo Electric Power Company (TEPCO) and Chubu Electric Power Company (Chuden) are expected to be 1.1% in July 2022, which is a lower level than the minimum requirement of 3%. In August 2022, the reserve margin of TEPCO and Chuden is expected to drop to 0.9%. Other areas such as Tohoku, Hokuriku, Kansai, and the Chugoku region also expect their reserve margins to drop to the 1-2% range.

In order to address this energy shortage crisis, the subcommittee discussed whether a requirement for the advanced notification of a plant shutdown could be a measure to slow down the phaseout of thermal power plants.⁸

Currently, utilities are allowed to notify a regulator regarding the shutdown of a power plant after they complete the shutdown. As a result, the government has recently received many late notifications of plant closures. However, it can take several months to more than a year for utilities to make up the generation loss of the power plan caused by the shutdown. Therefore, the subcommittee proposes modifying the existing procedure to require utilities to submit a revised power generation plan with the potential shutdown of certain power plants in advance and to conduct their power supply procurement before the shutdown of a plant.⁹

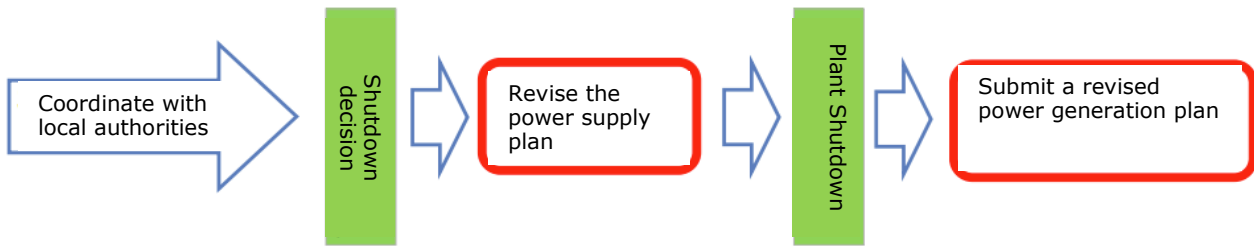
⁶ https://www.meti.go.jp/shingikai/enecho/denryoku_gas/denryoku_gas/pdf/043_03_02.pdf

⁷ <https://www.nikkei.com/article/DGXZQOUA2736U0X21C21A2000000/>

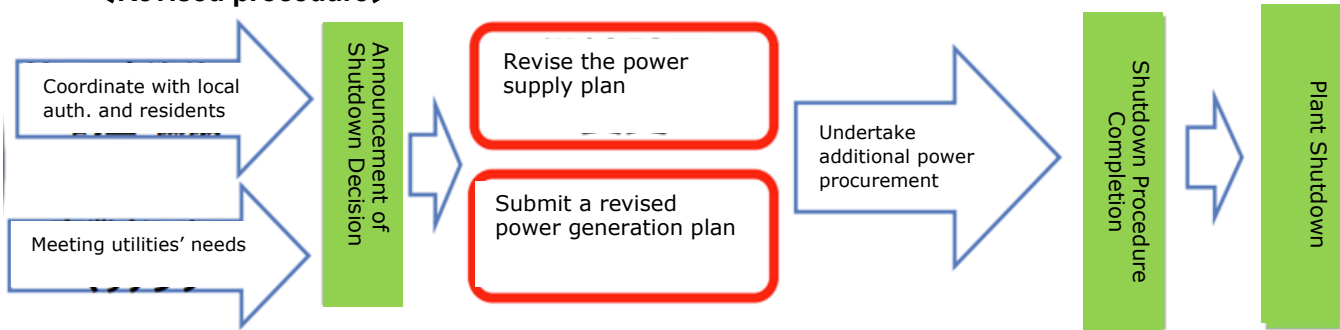
⁸ https://www.meti.go.jp/shingikai/enecho/denryoku_gas/denryoku_gas/pdf/043_03_02.pdf

⁹ https://www.meti.go.jp/shingikai/enecho/denryoku_gas/denryoku_gas/pdf/040_05_00.pdf

<Current procedure>



<Revised procedure>



Source: METI¹⁰

¹⁰ https://www.meti.go.jp/shingikai/enecho/denryoku_gas/denryoku_gas/pdf/040_05_00.pdf