China: The Investment Agenda for Building an Environmentally Sustainable Economy

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Association for Sustainable & Responsible Investment in Asia

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About ASrIA

ASrIA, the Association for Sustainable and Responsible Investment (SRI) in Asia, is a not-for-profit membership association dedicated to promoting and developing SRI in Asia. ASrIA's mission is to assist the financial community to understand and integrate sustainable investment criteria into investment decisions, and to empower investors by increasing the choice of SRI products available in Asia. Established in 2001, ASrIA already has more than 100 members, including investment institutions managing approximately US$2 trillion in assets in total. In order to raise awareness about SRI, ASrIA runs conferences, seminars and workshops, and publishes research on SRI issues. ASrIA's website, www.asria.org, is the primary resource for SRI in Asia, with over 1,800 page views per day and 4,600 subscribers to the regular e-bulletin. ASrIA is creating a powerful network of people and organisations committed to developing SRI in Asia.

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This paper gives an overview of the current status of environmental protection in China and considers the investment agenda for sustainable business enterprise. While the social dimension of development is just as critical to achieving sustainability, it is not the main subject of this report which focuses on the underlying environmental challenge.

- **The environmental state of the nation**
- **China's environmental policies and regulations**
- **Environmental management standards in industry**
- **Green initiatives and pilot projects**
- **An emerging agenda for investors who wish to support sustainable China**

Executive Summary

This is the 'Asia Pacific Century' and the question asked by concerned citizens worldwide is whether China, the largest economy in Asia, is able to prove that economic growth can exist in harmony with protection of the environment? Does the country have what it takes to be a world leader in green growth, living within its ecological footprint[1]? Can it afford not to?

"Harmony among the population, resources and environment is fundamental to realising a "xiaokang" – relatively affluent – society in an all round way"…

… "all government departments should have a sense of this responsibility"

Hu Jintao
10th March 2003

Output from China's 10 million industrial enterprises grew by more than 15 percent annually during the 1990s[2] and output is likely to continue to be among the highest globally especially with developments such as WTO[3] inclusion. Economic growth is frequently coupled with an increased burden on a country's ecosystem. While some environmental problems may be reduced, many are not. China's challenges are overwhelming. There is chronic air pollution from burning coal, water pollution from untreated wastes and soil erosion from deforestation. One-fifth of agricultural land is already estimated lost since 1949[4].

[1] Ecological footprints show us how much nature nations use. They are calculations based on two simple facts: first, we can keep track of most of the resources we consume and many of the wastes we generate; second, most of these resource and waste flows can be converted to a biologically productive area necessary to provide these functions. At the current rate of consumption, the ecological footprint of all humankind will reach twice the regenerative capacity of Earth by 2050.

[2] World Bank, 'Greening of Industry: Is Industrial Pollution the Price of Development.' 2002.

[3] China joined the World Trade Organisation (WTO) on November 11, 2001. There has already been a surge in investment activity following China's accession to the WTO - the Ministry of Foreign Trade and Economic Co-operation recorded 22,915 new enterprises backed by foreign direct investment during 2001 and this is expected to increase sharply over the next few years. Source: Ministry of Foreign Trade and Economic Co-operation. http://www1.moftec.gov.cn/moftec_en/ Also cited on People's Daily Newspaper, 'China More Attractive to Foreign Investors', December 2001, http://www.english.peopledaily.com.cn

[4] World Bank, 'China, Air, Land and Water – Priorities for a New Millennium.' 2001.

China has evermore sophisticated environmental legislation and substantial investments are being made in clean technologies and environmental rehabilitation programmes. Crucially these investments are being supported and championed by the World Bank, the Asian Development Bank (ADB) and other foreign investors. However, despite the level of environmental legislation in place, China's historical compliance record is poor and standards continue to be weakly enforced in some provinces, especially in rural areas. Fines are often too low or produce conflict issues by contributing more in the way of financial benefit to enforcement bodies than to mitigation of environmental impacts.

Nevertheless, the Executive is signaling its awareness of the costs of pollution and the opportunity to integrate environmental design more effectively into economic development, and decisive actions are being taken beyond the introduction of new laws. Between 1998 and 2000, heavy polluting plants in the country, including 52,500 small coal mines, 85 small iron and steel plants and 3,894 cement factories were closed down.[5] More recently the country has begun to introduce market mechanisms for environmental protection and reducing pollution. It is too early to comment on the impact of these, such as the emissions trading schemes to reduce sulphur oxides, and the Clean Development Mechanism to reduce greenhouse gas emissions. However, given the mercantile nature of Chinese people, there is a high likelihood that such measures will have broader appeal and positive impact than the stick of legislation alone.

Issues for Investors

Only ten years ago, corporations and investors would have seen China as a pollution haven where environmental standards were allowed to 'let slip' and of secondary importance to rapid economic growth. However the authorities have tightened their grip and businesses setting up in China can expect growing levels of scrutiny. Nonetheless standards do vary significantly in different regions. Investors[6] hoping to participate in China's economic growth without contributing to further environmental degradation, or better, making a positive contribution to environmental protection and mitigation measures, can do so in several ways, described in Section 5 of this report. In short, they can:

Consider developing an ***Environmental Code of Conduct*** for investments in China which reinforces the effectiveness of Government programmes focused on environmental management systems, on emissions compliance, on eco-labelling, on cleaner production and on environmental accounting. If there is sufficient interest in this proposal, ASrIA is willing to work with investors and investee companies to develop such a Code.

"There is an increasing consensus in this country that Western-style modernisation is not a ready-made model for China.....

..... China's ability and resolve to press ahead with its own approach to overall development should not be underestimated"
China Daily 19.7.03

[5] *China Daily* , 'Clear skies ahead for Chinese cities.' November 8, 2002.
[6] For the purposes of this report, the term Investors is used to describe foreign investors, stock market investors specifically, since China has yet to develop a domestic SRI industry. Nevertheless many of the recommendations made should also be considered by domestic investors and overseas investors of all types. It is also recognised that the primary concern of investors in Chinese companies is to ensure that Reports & Accounts represent a true and fair view. However environmental factors in corporate performance should not be neglected.

- Encourage companies to adopt environmental management systems such as ISO14001 and to provide independent verification of their records. Actions such as environmental training programmes for staff or championing of environment performance from senior management should be encouraged.
- Encourage greater environmental performance transparency by companies and their suppliers through environmental reporting. Standards such as those defined by the Global Reporting Initiative should be considered.
- Use the opportunity of the Beijing Olympics to push developers towards green buildings and sustainable urban design.
- Encourage the Government to foster the growth of SRI practice and corporate sustainability through measures such as Stock Exchange listing requirements.
- Support the development of benchmarks such as Sustainability Market Indices and case studies of best practice, for example in Cleaner Production, to demonstrate new management techniques and provide quantitative evidence of the commercial benefits of natural capital management.
- Support projects which foster business (and public) understanding of sustainable enterprise, global best practice and the transition strategies required for key industries.
- Support local capacity building for sustainable investment practice.
- Support supply chain measures to raise environmental standards in domestic production, especially in China's less developed areas.
- Investors must also develop wider investment capabilities, for example, their capacity to support sustainable venture finance and microfinance. Solutions for sustainability require more than stock market investment.

The international and domestic legal frameworks are in place to ensure that economic and business development can be aligned more closely with environmental protection. Stronger enforcement of these regulations is needed by government, and market forces can reinforce government action.

Stock market investors can be a strong and positive influence on companies when they analyse sustainability factors in due diligence and discuss these issues with management.

Multinationals and international investors can significantly influence best practice if they make good environmental management a pre-requisite for investment and also explain the importance of it to the investment case. This requires active engagement by investors with multinationals investing into China and requires these multinationals to be involved with education and management training of local operators. Tolerating poor environmental management and taking short cuts today will usually lead to larger costs in the future for clean-up of liabilities. International and domestic pressure to comply with regulations and requirements will continue to increase.

Much has been written about China's environmental challenge and references to more detailed accounts are given in Appendix 1. This paper aims to provide a brief overview of some of the greatest challenges and the status of legislation governing China's natural capital management. The main purpose is to identify how investors can support the integration of environmental priorities into an economy which is growing at a staggeringly rapid pace.