

Chapter 5

Environmentally Responsible Corporate Conduct in China

Economic growth and industrialisation in China, characterised by heavy reliance on coal as the main energy source and rapid urbanisation, have been accompanied by negative impacts on the environment which have been increasingly visible in recent years. This has raised environmental awareness and concerns among political leaders, government officials and the public in China. This chapter outlines the challenges faced by the Chinese government in encouraging environmentally responsible conduct on the part of Chinese enterprises and possible policy options to address these challenges.

Overview

Economic growth and industrialisation in China, characterised by heavy reliance on coal as the main energy source and rapid urbanisation, have been accompanied by negative impacts on the environment. These impacts have been increasingly visible in recent years. This has raised environmental awareness and concerns among political leaders, government officials and the public in China.

After a series of serious environmental incidents, there seems to be a consensus at the central government level that addressing issues of environmental degradation is a high priority as stated in the State Council's *Decision on Implementing the Scientific Concept of Development and Strengthening Environmental Protection*. Consistent with policy statements to commit to environmental protection, the government has accelerated its efforts to develop the legal framework and standards for environmental protection, and has harnessed such concepts as Cleaner Production, Circular Economy, Environmental Impact Assessment and Renewable Energy to shift its approach from "end-of-pipe" management to entire process management. As a result, China now has a fairly comprehensive system of environmental laws and regulations coupled with environmental standards, some of which even exceed those in OECD member countries.

Despite China's comprehensive system of environmental laws and standards, implementation and enforcement are facing formidable challenges. 1) The capacity of environmental regulatory authorities, especially at local level, is still weak and local government administrations continue to give entire priority to economic growth over environmental protection. 2) The legal apparatus, including lawyers and judges conversant with environmental litigation and civil society groups experienced in class action suits against industries for pollution damages, is still underdeveloped. 3) A market-based incentive mechanism for environmental protection and pollution reduction has not yet been adopted. While the government has been introducing measures to tackle these challenges, it is important that the non-government sector, especially the business sector, needs to play a bigger role in environmental protection.

The business case for environmentally responsible conduct is multi-faceted. The case may include a reduction in production costs due to improvements in resource use efficiency and reduction in waste discharge,

increased sales and demand from “green” customers and environmentally conscious retailers, lower staff turnover costs, lower capital costs, and better reputation and company image. The business case for environmentally responsible conduct is expected to grow stronger as more Chinese enterprises expand their operations abroad, as the environmental awareness of the general public in China rises, and as the Chinese government introduces further environmental protection measures and improves its enforcement capacity.

Chinese enterprises have been gradually recognising the value of being environmentally responsible. There is, however, a wide variation in implementation of these responsible environmental conduct tools among enterprises in China. Large enterprises with global operations are more likely to obtain environmental certifications such as ISO14001 and enterprises in industries considered most environmentally damaging are more likely to disclose environmental information. So are enterprises with foreign capital or joint-venture enterprises, as they may be instructed to do so by the foreign parent enterprise.

Voluntary corporate efforts to improve environmental performance, though emerging, are still limited in China. Few Chinese enterprises have set up internal units dedicated to environmental management and conducted regular environmental audits. It is not uncommon to find enterprises taking advantage of the weak enforcement capacity of environmental authorities, and local administrations ignoring the environmentally harmful operations of enterprises that are contributors to local economic growth and government revenue. Since many Chinese enterprises and sectors still operate at far lower energy and resource efficiency than the international average, the marginal gain from improving corporate environmental performance may be very large. Such enterprises can learn from practices and experiences of environmentally responsible conduct from foreign enterprises, for example via business partnerships.

Aware of the potentially important role of the business sector in protecting the environment, the government not only has strengthened its law enforcement capacity but also has made progress in encouraging enterprises’ voluntary efforts. It has awarded honorary titles to enterprises with excellent environmental performance, publicised good enterprise practices in the media, developed a system to evaluate corporate environmental performance and provided guidelines¹ for enterprises on how to conduct business in an environmentally responsible manner.

As more Chinese enterprises are “going global”, they are facing the challenge of meeting the standards and expectations of the international market. In some cases, Chinese enterprises operate in countries and territories where environmental regulation enforcement is much weaker than in China, while at

the same time they have to deal with a wider array of stakeholders and a more diverse range of expectations. Enterprises failing to understand and respect the local business environment including laws and regulations, market expectations and community demands are increasingly under pressure to modify their practices in host countries. One enterprise's irresponsible behaviour may tarnish the country's image, creating a negative externality for other Chinese companies operating in the same host country or region. For Chinese enterprises to expand and sustain their operations abroad successfully, collective commitments to conduct business in a responsible manner are crucial.

In this context, international standards such as those reflected in the *OECD Guidelines for Multinational Enterprises* are particularly useful, as they provide a common frame of reference for enterprises to help ensure that their operations are compatible with expectations by host countries. The *Guidelines* can also serve as a tool for interpreting the meaning and guiding the application of other international instruments and domestic laws. Adoption of voluntary codes of responsible business conduct reflecting the principles of the *Guidelines* can reassure the public by relieving anxieties about enterprises' business models, intentions and impacts on the environment. Finally, implementation of these voluntary codes by enterprises will contribute to poverty reduction and sustainable development.

1. The regulatory framework for the environment in China

As China's economy has rapidly industrialised and expanded, heavy reliance on coal for industrial production and home heating and, more recently, increasing demand for automobiles, have caused severe air pollution. Water usage and the discharge of wastewater from agricultural, industrial and domestic sources have polluted water courses, lakes and coastal waters. The increase in total waste generation has exceeded the increase in capacity to treat and dispose of waste safely, resulting in a proliferation of uncontrolled dumps surrounding the cities.

Negative environmental impacts of China's industrialisation have been aggravated by the weak enforcement capacity of environmental authorities, a low awareness of environmental rights and conditions by the public, artificially-set low prices of industrial inputs such as energy, land and water, and insufficient investment in environmental infrastructure.

Concerned with the deteriorating environmental situation, the Chinese government now promotes a more balanced model of economic development, expressed by such concepts as "harmonious society"² and the "scientific concept of development".³ The government has been actively introducing measures to arrest environmental degradation. For example, in 2007 China increased the percentage of coal-fuelled power plants with desulphurisation facilities and the

rate of urban sewage treatment, and reduced total chemical oxygen demand (COD) discharge and CO₂ emission.⁴ Despite recent improvements, China still faces enormous challenges in developing a resource saving and environmentally friendly society.

The 2007 OECD *Environmental Performance Review of China* (EPR China) provided a fuller account of China's environmental situation and policies and made a series of recommendations, including to "improve governmental oversight and environmental performance in the overseas operations of Chinese corporations (in the spirit of the *OECD Guidelines for Multinational Enterprises*)". Building on *EPR China*, this section summarises and updates the overall efforts of the Chinese government in environmental protection and focuses on the approaches of the government to encourage enterprises' responsible environmental conduct.⁵ Consistent with earlier findings of *EPR China*, it identifies an "implementation gap" as the major issue in improving enterprises' environmental performance and explains the factors behind this "implementation gap".

Development of China's environmental policies and legislation

China has developed a comprehensive system of environmental laws and regulations coupled with various environmental standards (for a list of major environmental laws, regulations and policies, see Annex 5.A1). While the Environment Protection Law (EPL) promulgated in 1979 remained a trial law for the following ten years,⁶ since the second half of the 1990s China has accelerated the enactment of new environmental legislation and strengthened existing environmental laws.⁷ The Chinese government has formulated 9 laws on environmental protection, 15 laws on the protection of natural resources, 50 administrative regulations by the State Council on the environment, and more than 600 environmental rules and regulations by various departments under the State Council and local governments. These are complemented by more than 800 national and local environmental standards including environmental quality standards, pollutant discharge standards and standards for environmental samples. Over the years, the scope of environmental policies has become more specific and policy objectives clearer, detailing both the priority geographical areas for environmental protection and the priority topics. The Tenth Five-Year Plan (2001-05) contained for the first time concrete objectives and quantitative targets for environmental performance improvement.

After a series of serious environmental incidents and related public protests, the government expressed its clear policy to commit itself to environmental protection and pollution reduction in the *Decision of the State Council on Implementing Scientific Concept of Development and Strengthening Environmental Protection* (2005). This represents the government's

acknowledgement that environmental degradation and pollution are leading causes of social unrest. It aims to give environmental protection a more important strategic position in implementing “the scientific concept of development”, accelerating the development of what it terms a “socialist harmonious society” and achieving the goal of building a “well-off society”.

In recent years the government has quickly harnessed such concepts as Cleaner Production,⁸ Environmental Impact Assessment⁹ (EIA), Renewable Energy¹⁰ and Circular Economy¹¹ and has shifted its approach from “end-of-pipe” management to entire process management. The current Eleventh Five-Year Plan (2006-10) supports the transformation of economic growth model from one ignoring environmental protection to one emphasising both growth and environmental protection, from one of environmental protection lagging behind economic growth to one of synchronising the two, and from main use of administrative methods to use of comprehensive application of legal, economic, technical and administrative methods to address environmental problems. The Plan continues to set the quantitative environmental targets including a 20% reduction in energy consumption per unit of GDP, a 10% reduction in total COD discharge and sulphur dioxide (SO₂) emission, a 30% reduction in water consumption per unit of industrial value-added, and a 60% recycling rate of industrial solid waste by 2010.

Recognising the role of responsible business conduct in environmental protection

In developing a legal framework for environmental protection, the Chinese government has also recognised the role of enterprises in advancing its environmental agenda. For example, the China National Environmental Protection Plan in the Eleventh Five Years (2006-10) spelled out its intention to promote corporate responsibility by introducing incentive mechanisms, encouraging environmental disclosure, and enhancing a public supervision system.

In December 2007, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) issued *the Guidance on Fulfilling Social Responsibilities*¹² for large state-owned enterprises (SOEs) under its supervision to: 1) enhance awareness of social responsibility; 2) establish a division responsible for social responsibility; 3) publish a report regularly on social responsibility or sustainable development and conduct stakeholder consultations; and 4) learn from foreign companies’ best practices and experiences on social responsibilities.

Environmental Impact Assessment (EIA)¹³

The Environmental Impact Assessment (EIA) is the main regulatory instrument for environmental protection in China and a requirement for all

development projects under the EIA Law 2002.¹⁴ Under this law, construction firms are obliged to obtain approval for environmental impact assessment of their projects from relevant administrative departments before starting construction, and to implement the environmental protection and impact mitigation measures detailed in the assessment during the construction period. The EIA Law provides for a strategic environmental assessment to complement the project-oriented EIA process in regional and sector plans and programmes.

The Ministry of Environmental Protection (MEP, upgraded from the State Environmental Protection Administration, SEPA, in March 2008) conducts nationwide checks on the implementation of EIAs and publishes the results on an annual basis. The rate of EIA enforcement increased from 61% in 1991 to 98.3% in 2002 and has exceeded 90% since 1998.¹⁵ To encourage public participation in the EIA process, SEPA issued guidelines¹⁶ in 2006 specifying the scope, procedure and form of public consultation during the EIA process as well as requiring disclosure of environmental information to the public.

Market-based instruments to promote environmental protection

To complement environmental laws and regulations, the Chinese authorities use market-based policy instruments to promote environmental protection and pollution reduction. These include a system of charging for pollutant and waste discharge, a discharge permit system (DPS) to limit the quantity and concentration of pollutant discharge, and a tax and subsidy structure geared towards environmental improvements.

A comprehensive pollution levy system was in place in nearly all counties and cities in China by 1996.¹⁷ The system includes discharge fees on major pollutants, urban sewerage, urban solid wastes, and hazardous wastes. Discharge fees are charged for total amounts of pollution discharge and a higher rate is prescribed for amounts exceeding the national standards as opposed to the past formula under which discharge fees were only applied to amounts exceeding the national concentration standards. 80% of funds collected from discharge fees are returned to enterprises for pollution control investments. However, the fees are still too low to encourage enterprises to install pollution control and treatment, and local environmental protection bureaus (EPBs) in charge of the administration of the levy system tend to exercise considerable discretion over implementation and enforcement of the system.

The DPS is implemented by local EPBs, which issue permits limiting both the quantity and the concentration of pollutants in wastewater and air emission to each enterprise. Hence, an EPB allocates allowable pollution loads to each enterprise under its jurisdiction and monitors compliance. Though the central

government provides guidance to local EPBs, the design and implementation of DPS are not uniform, showing substantial variation at the local level.

The tax and subsidy structure also incorporates environmental considerations.¹⁸ For example, the government has annulled the tax rebate entitlement on exported products for polluting industries such as iron and steel, electrolytic aluminum and iron alloy. Consumption tax has been reduced for automobile producers who have achieved the low pollution emission standard ahead of schedule. General tax reductions or exemptions have been extended to enterprises engaged in renewable resources, cleaner production, production of environmental protection equipment, and in the use of wastes as main inputs of production.

The government has initiated use of financial markets for the purpose of environmental improvement. In July 2007, SEPA, the People's Bank of China (PBOC) and the China Banking Regulatory Commission (CBRC) jointly issued a green credit policy.¹⁹ This established a co-ordination mechanism between environment protection agencies and credit administration institutions in an effort to limit the expansion of high energy consumption and highly polluting industries and promote projects for energy saving and emissions reduction. SEPA subsequently provided more than 30 000 pieces of information on violation of environmental laws to the Credit Information System Bureau so that commercial banks could use this information to suspend or limit loans to enterprises violating environmental laws. The PBOC and its branches are expected to guide commercial banks to include environmental performance in their credit risk management and lending criteria.²⁰ Following the policy, several financial institutions and local governments suspended loans, cut down credit lines, and withdrew loans to enterprises which violated environmental laws and regulations.

SEPA and the China Insurance Regulatory Commission (CIRC) jointly issued a green insurance policy²¹ in 2007 which presented a road map for establishing an environmental liability insurance system in China by 2015. Given a large and increasing number of environmental incidents in the country,²² the policy is a step forward to introduce market forces to manage and share the risks and costs of environmental damage. If the environmental insurance system works well, insurance companies would monitor enterprises' environmental conduct, compensate victims in a timely manner, and relieve the government's financial burden.

In February 2008, SEPA promulgated a green securities policy²³ which made an environmental audit one of the prerequisites for IPO or refinancing through the securities market by enterprises in thirteen heavily polluting industries²⁴ and required environmental information disclosure by listed companies. This policy aims to restrict an increase in capital raised by heavily

polluting companies through the securities market as well as to protect investors from the capital risks associated with government sanctions on enterprises violating environmental regulations and tightened environmental regulations. SEPA conducted environmental performance reviews of 37 companies applying for an IPO in 2007,²⁵ and refused applications from 10 companies which had constantly failed to meet waste discharge standards or had experienced major pollution incidents.

Trade and FDI policies have also been adjusted to fit the environmental agenda. In October 2007, SEPA and the Ministry of Commerce (MOFCOM) announced a “green trade policy”.²⁶ Under this policy, the government does not grant export quotas and licences, approval of processing trade contracts or projects, participation in national and regional export fairs, and approval of export business establishment to enterprises which violated environmental laws and regulations. In December 2007, MOFCOM revised *the Catalogue for Guiding Foreign Direct Investment* with environmentally friendly investment projects newly added to the encouraged categories.²⁷

Enforcement of environmental laws and regulations by the Chinese government

The government has been making continuous efforts to enforce environmental laws and regulations by strengthening the legal framework of penalising violation of environmental laws and regulations and exercising administrative sanctions on polluting industries.

The legal basis for pollution damage liability and related compensation claims can be found in the General Principles of Civil Law 1986²⁸ and the EPL 1989,²⁹ while a number of specialised environmental protection statutes on air, water, solid waste, and noise also contain provisions concerning liability for pollution.³⁰ In addition, China’s criminal law was amended in 1997 to address the crime of impairing the protection of the environment and resources. In 2006, the government promulgated *the Interim Regulations on the Punishment of Violations of Environmental Protection Laws or Regulations* which made the responsibility of environmental law enforcement clearer for local administrative officials. Though China’s legal framework is in theory sufficient to claim compensation for damages caused by violation of environmental laws, legal procedures are yet to be of common use in China.

The government often issues decisions or guidelines concerning environmental protection which trigger administrative sanctions on polluting enterprises and industries. For example, the State Council issued decisions concerning environmental protection issues in August 1996 which led to the closure of 15 categories of township and village enterprises that were considered particularly harmful to the environment including pulp and paper

mills, tanneries and zinc smelters. In July 2007, SEPA carried out a watershed permit restriction programme under which it denied permits to new industrial projects in 13 cities and development zones that suffered from serious pollution in the major watersheds of the Yangtze, Yellow, Huai and Hai Rivers.³¹

Constraints in the government's implementation of environment laws and policies

While China currently possesses an extensive regulatory framework that in theory should safeguard its environment, effective law enforcement has been a challenge for the government.

Major constraints faced by the government in implementing its environmental regulations include:

- Lack of detail in implementation procedures and absence of strictly-defined and effective penalty clauses under the laws: for example, the Law on Renewable Energy sets a target of 15% of electricity coming from renewable sources by 2020, but it remains non-operational without implementing rules and regulations. In many cases, interpretation of the laws is left to local EPBs' discretion, but without the legal basis defining the responsibilities and powers of local EPBs they cannot enforce the laws effectively.
- Conflict of interest at the local level:³² EPBs operate in a so-called dual-leadership system where they are not only reporting to higher-level EPBs, and ultimately to the MEP, but also are subordinate to local government instructions. Local governments can exert influence on EPB operations as they have control over EPBs' financial and human resources³³ while the MEP has limited direct influence over EPBs. Hence, when the local governments prioritise economic growth over environmental performance,³⁴ it is difficult for EPBs to carry out their mandate.
- Inter- and intra-co-ordination problems: At the central level, the MEP shares its responsibility for protecting environment with other government bodies such as the Ministry of Agriculture, the Ministry of Communications and Transport, the Ministry of Land Resources, the Ministry of Supervision, the Ministry of Water Resources and the State Oceanic Administration. The unco-operative attitude of these government bodies has hampered the MEP's (and before that, SEPA's) execution of its mandate and made policy co-ordination difficult.³⁵ At the local level, environmental protection duties are also distributed across many sectors including those that have also a responsibility for environmental protection, water conservancy, transport, land resources and public security. Hence, a lack of clear distinction in duties and co-ordination mechanism has undermined effective environmental protection.

- Insufficient resources and capacities of environment protection authorities: About 2 500 local EPBs which have been delegated day-to-day responsibility for enforcing environmental regulation compliance often lack the proper technology and manpower to conduct thorough monitoring of enterprises and enforce emission standards.
- Lack of assistance to local communities to mitigate the impact of environmental protection measures makes it difficult for local governments to take strict measures on polluting enterprises as they are concerned about the job losses that may result.
- Lack of sufficient incentives for enterprises to comply with the laws: Pragmatic enforcement of laws by EPBs discourages enterprises from rigorously respecting the law. For example, the discharge fees whose basis is prescribed in the regulation are in reality negotiable with EPBs or local governments.

Efforts to raise the effectiveness of government enforcement of laws and regulations should continue. However, even when the government's law enforcement is weak, the responsibility of enterprises is to comply with environmental regulations and to respond to societal expectations which may be communicated by other channels than laws.

2. Role of the business sector in environmental protection

Business case for environmentally responsible conduct³⁶

The business case for environmentally responsible conduct is multi-faceted and is getting stronger in China. Chinese enterprises are learning from global experiences that the long term profitability and sustainability of business operations are likely to be secured with enterprises' commitments to responsible business conduct. Enterprises can increase or maintain their profits in the long term by listening to, engaging and responding to stakeholder groups including shareholders, employees, customers and communities.

The business case for environmentally responsible conduct includes the following arguments:

- More efficient use of energy and resources and less discharge of waste contribute to production cost reduction, hence to increased profitability. This case is getting stronger as the prices of resources as well as the fees of waste discharge are increasing.
- Enterprises may be able to charge a price premium on environmentally friendly products by attracting "green" customers, the number of which is increasing world-wide. In the international market, more consumers may choose suppliers based on their green practices, and more downstream

retailers in the supply chain may require their suppliers to achieve a certain level of environmental protection and safeguards.³⁷

- By anticipating new markets, products or services which are increasingly characterised by society's desires for a cleaner, safer and more sustainable world, enterprises can capture new business opportunities and differentiate themselves from competitors. Innovation and the search for new technologies may be promoted by trying to understand and respond to the business opportunities arising from changing environmental values.³⁸
- By being environmentally responsible, enterprises can improve as well as protect their reputation and brand image. According to one survey of Chinese enterprises,³⁹ "improving corporate image and contributing to corporate market competition" was cited as the main reason for conducting business responsibly by 73% of the surveyed enterprises.
- Environmentally responsible enterprises may attract employees with higher work ethics, motivate employees better and retain them longer, leading to higher labour productivity and lower staff turnover costs.
- Enterprises may reduce the costs of capital by having access to environmentally conscious investors and financial institutions.
- Responsible enterprises can pre-empt advocacy groups from organising to press the political forces for stricter regulations and to hold demonstrations harmful to business such as product boycotting. With significantly lower internal and external communication costs, civil societies can now mobilise the public for action in a much easier manner.
- Enterprises viewed by regulators as environmentally responsible are likely to be monitored less frequently, and hence can reduce the costs of regulation compliance.
- Enterprises can also benefit from various incentive schemes provided by the government.

As business practices become more transparent, environmentally responsible conduct will become not a luxury but a requirement for many enterprises. It is an integral part of risk management strategy for enterprises, especially those with environmentally sensitive operations. In China energy and resource efficiency is still lower than the international average⁴⁰ and many cost-effective interventions that have been adopted in industrialised countries have not yet been tried there. This implies that enterprises' responsible environmental conduct can greatly boost social welfare as the marginal benefits from adopting environmental interventions exceed the marginal costs in China.

Environmentally responsible conduct by business in China: Example

As summarised in *Environment and the OECD Guidelines for Multinational Enterprises* (2005), enterprises have “a growing number of off-the-shelf environmental management tools, reporting and information codes and sectoral guidelines and recommendations”. The prominent tools include: environmental audit, external certification of environmental management system (EMS),⁴¹ reporting of environmental information in accordance with widely accepted reporting standards,⁴² obtaining or developing eco-labels, partnerships with civil society groups in conducting stakeholder consultation, adhering to voluntary environmental codes of conduct,⁴³ environmental education and training programmes for staff, contractors and local communities, and contribution to the development of environmental policy via dialogue and policy advocacy.

Typically observed practices in environmentally responsible business conduct in China include: 1) publishing environmental or sustainability reports;⁴⁴ 2) implementing environmental management systems, many of which are certified for or compatible with ISO14001;⁴⁵ 3) negotiating agreements with local governments on environmental performance improvements; 4) upgrading equipment and technology to be more energy efficient and environmentally friendly; 5) installing on-line monitoring systems to address the shortage of monitoring staff, reduce monitoring costs and increase monitoring efficiency; 6) conducting employee education and training programmes; and 7) constructing green facilities in corporate premises such as gardens, lakes and green walls.

A substantial variance, however, exists in implementation of these responsible environmental conduct tools among enterprises in China. Enterprises that are more likely to implement the tools are large enterprises that have global operations. According to one survey,⁴⁶ enterprises in the industries which are traditionally seen as most environmentally damaging including mining, paper and printing, power and fuel are more likely to disclose environmental information. So are enterprises with foreign capital or joint-venture enterprises as they may be instructed by the foreign parent enterprise.

The growing attention to responsible business conduct in China is also demonstrated by the launch of China Business Council for Sustainable Development (CBCSD) in early 2004⁴⁷ as a coalition of Chinese and international enterprises with a shared commitment to maintain and promote sustainable development through environmental protection, corporate responsibility, economic growth and social equity. There are emerging domestic efforts at sector and industry level to promote sustainable development principles and self-regulating guidelines on environmental

protection. These sector- or industry- specific efforts are led by industry-specific business associations as well as regional chamber of commerce.⁴⁸

Enterprise A⁴⁹

Enterprise A is a state-owned enterprise with oil and gas business in China and abroad. It owns 30 international exploration and production projects with operations in Azerbaijan, Canada, Indonesia, Kazakhstan, Myanmar, Oman, Peru, Sudan, Thailand, Turkmenistan, and Venezuela. Enterprise A started publishing a sustainability development report in 2006.

Enterprise A is currently implementing the three-year plan (2008-10) of pollution control and energy conservation that includes ten major energy saving projects, ten major pollution reduction projects and three demonstration units of circular economy. It partnered with the State Forestry Administration and China Green Foundation in 2007 to establish the Green Carbon Fund that can be used by businesses, civil society groups and individuals for voluntary activities in tree plantation and forest protection.

As a large enterprise with global operations and subsidiaries, enterprise A has adopted effective measures to implement its environmental accountability system. For example, the President of enterprise A signed safety and environment accountability agreements with the heads of 128 enterprises affiliated with enterprise A that specified various aspects of the accountability system. In turn the affiliated enterprises signed accountability documents internally at various levels to define responsible personnel and the range of responsibilities and incorporated a responsibility performance index in the annual performance evaluation of managers. To manage its global operations better, enterprise A formed three regional companies based in South America, Sudan and Kazakhstan with a health, safety and environment (HSE) business manager at each regional company⁵⁰ so that the routine HSE management functions could be transferred to these regional companies.

Enterprise A regularly monitors and publishes progress in conserving energy and water and reducing discharge of pollutants. It has invested in sewage treatment stations, cleaner technologies, ecological restoration and gas recovery projects, and has devoted resources to the R&D of developing energy efficient equipment.

Enterprise B⁵¹

By end-2005, enterprise B had invested USD 3.5 billion on the Chinese mainland and established some 21 wholly-owned or joint ventures with 1 600 staff in the field of exploration and production, gas and power, oil

products and chemicals, and renewable energy. It actively partners with all three of China's main oil and gas enterprises.

As part of a multinational grouping, enterprise B ensures an environmental and social impact assessment to be made at each project level. The assessment standards meet both Chinese and international standards. Enterprise B has transferred environmentally friendly technology such as the technology in sulphuric acid plants⁵² and coal-gasification technology through a strategic alliance with a Chinese oil major⁵³ and via licensing agreements with eleven other Chinese enterprises.

Implementation constraints faced by business in China

Despite emerging enterprise attempts to improve environmental performance, voluntary industry efforts are still limited in China. There is a tendency for enterprises to take advantage of the weak enforcement capacity of environmental authorities. For example, it is not uncommon for enterprises and local environmental authorities to negotiate downwards the environmental standards or penalties. Many enterprises may superficially comply with environmental regulations by putting pollution control plants into operation only when inspectors are expected. Only a minority of Chinese enterprises have set up a specific unit in charge of corporate social responsibility or environmental management. Supply chain audit is not commonly undertaken by Chinese enterprises. Where there are no environmental laws or regulations in host countries, Chinese enterprises operating in these countries are likely to adopt lowest cost investment plans.

There are three main reasons why Chinese enterprises are constrained in taking up environmentally responsible conduct. First, the awareness of environmental issues and the commitment to address environmental degradation are generally low among Chinese managers and employees. There remains a widespread underestimation among Chinese enterprises of the benefits of responsible business conduct and a consequent reluctance to take the initiatives.⁵⁴ Many still share the misconception that standards of responsible business conduct are used by the industrialised countries to restrict access to the market against Chinese enterprises.

Secondly, many Chinese enterprises have focused on price competitiveness and performance evaluation has emphasised short-term profitability.⁵⁵ Foreign companies sourcing their retail products from China continue to impose onerous price and delivery schedules which may limit the suppliers' capacity to improve performances other than cost competitiveness. Hence, a major shift in operation mode and strategy will be required for these enterprises to start seriously considering environmental performance.

Thirdly, incentives to support enterprises' voluntary efforts to engage in environmentally responsible conduct such as expectations regarding enterprises' environmental behaviours on the part of civil society or local government have not been sufficient.

The government role in encouraging environmentally responsible conduct in China

To realise the potential role of enterprises in achieving environmental goals, the government can not only enact and enforce environmental laws and regulations. But it can also strengthen the business case for enterprises to conduct operations in an environmentally responsible manner.

The simplest way to strengthen the business case for environmentally responsible conduct is to increase the costs of non-compliance with environmental regulations and increase the rewards for good environmental performance as part of efforts to strengthen the government law enforcement capacity. For example, the government can raise discharge fees for pollutants and penalties for non-compliance, at the minimum, to the extent that the cost of polluting or non-compliance exceeds the cost of controlling pollution or compliance. When pollution-related damages are internalised in accordance with the polluter-pays principle, enterprises will be encouraged to take pollution mitigation measures in response to the price signal.

The government can support the development of grassroots environmentalism by allowing civil society groups to play a greater role in environmental protection.⁵⁶ International experience shows that environmental movements can bring about changes through pressuring enterprises to operate in an environmentally responsible manner. The Chinese government is making some progress in this aspect as consistent with the agenda put forward by the *Decision of the State Council on Implementing Scientific Concept of Development and Strengthening Environmental Protection*.⁵⁷ Public consultation in environmental protection and disclosure of environmental information are required in certain circumstances under the EIA Law and more generally under the Administration Licence Law.⁵⁸ The MEP (then SEPA) subsequently issued implementation measures for these both laws to guide EPBs and local governments.⁵⁹

However, activities of civil society groups in the environmental field remain over-regulated in China⁶⁰ and there will be a long way before civil societies can act as the effective watchdog for enterprises' environmental conducts⁶¹ and the government's enforcement duties. At a more general level, the government may wish to support environmental education though either its own programmes or civil society groups' campaigns so that public consultation and participation become more effective in environmental protection.

The government can also encourage further disclosure of environmental information as disclosure may lead to improved compliance and enforcement due to increased public scrutiny.⁶² The media can play an influential role in environmental protection by exposing cases of environmental law violation, providing environmental information to the public and reporting pollution incidences and accidents.

The government has made some progress in information disclosure by publishing a list of enterprises violating environmental laws and regulations since 1996.⁶³ SEPA issued national implementation guidelines⁶⁴ on how to rate and disclose enterprise environmental performance in 2007. It not only recommends EPBs to disclose the government environmental information to the public including a list of enterprises in violation of environmental laws and regulations but also encourages enterprises to disclose environmental information voluntarily by providing certain incentives.⁶⁵ However, a systematic mechanism for environmental information disclosure and a credible environmental performance rating system that are required to influence the environmental behaviour of enterprises have not yet been well-established in China.

The government can support an increased use of administrative and civil law cases against environmental law violation so that a legal penalty could become an effective deterrent for polluting enterprises.⁶⁶ The Chinese court system, if supported with adequate capacity and independence from political pressures, should be able to check the weak enforcement of environmental laws and regulations at the local level. Lawsuits can be made also against EPBs for not sufficiently enforcing environmental protection laws.

Although the number of environmental lawsuits has been increasing,⁶⁷ China has traditionally resorted to administrative sanctions more than legal sanctions. EPBs rarely make recourse to courts as they prefer mediation and conciliation and do not possess adequate technical capacity to gather evidence required to support their claims. Class action lawsuits against local industries for pollution damage often face obstacles in the courts, whose decisions may be influenced by local governments wishing to protect local industries. Furthermore, the Chinese legal system has too few judges trained in environmental litigation.⁶⁸

The government can develop a systematic and credible mechanism to evaluate and recognise enterprises' environmental performance. This mechanism can help enterprises gain public recognition for their environmental efforts, leading to increases in sales and profitability. Financial institutions and investors can use this information to decide which enterprises or projects to finance and invest in, adding to economic pressures on enterprises. Although the government has introduced environmental awards and labels⁶⁹ such as the

National Advanced Enterprises on Environmental Protection and China Environmental Label, the effectiveness of these awards and labels has been limited. The government aims to spread its pilot programme of appraising enterprises' environmental conduct to all cities by 2010.⁷⁰

Finally, the government can benefit from international co-operation in the environmental field by exchanging experience and learning from international good practices. The China Council for International Cooperation on Environment and Development (CCICED)⁷¹ was established in 1992 as a high-level advisory body consisting of both domestic and international experts. It has provided policy recommendations and advice to decision makers in the government and worked to raise public awareness in China on environmental issues.

International co-operation is particularly valuable in helping the government guide Chinese enterprises operating abroad with regard to their environmental responsibilities. The government has already issued some guidance to certain Chinese enterprises operating abroad including *Nine Principles on Encouraging and Standardising Foreign Investment*,⁷² the *Guideline on Sustainable Management of Overseas Forests for Chinese Enterprises*⁷³ and the *Guidelines on Fulfilling Social Responsibility by Central Enterprises*. Currently, however, there are no explicit policies or regulations in place to reward or penalise Chinese enterprises operating abroad based on their environmental performance.⁷⁴ To complement its "go global" strategy which encourages Chinese enterprises to make investment abroad, the government may wish to ensure that Chinese enterprises with global ambition operate in a manner consistent with international standards.

Role of international standards

By the end of 2006, China had accumulated USD 90.6 billion of outward foreign direct investment (OFDI) stock, realised through the remarkable surge of outward investment flows from China during 2000-06 at an average annual growth rate of over 60%. China's OFDI flow and stock now stand the 4th largest and the 6th largest, respectively, among developing countries.⁷⁵

As more and more Chinese enterprises are going global, they are increasingly under pressure to meet the standards and expectations of the international market. In some cases, Chinese enterprises operate in countries and territories where environmental regulation enforcement is much weaker than in China while at the same time they have to deal with a wider array of stakeholders and a more diverse range of expectations. Enterprises failing to understand and respect the local business environment including laws and regulations, market expectations, and community demands are unlikely to develop sustainable business operations in host countries. One enterprise's

irresponsible behaviour may tarnish the whole country's image, spreading a negative externality to other Chinese companies operating in the same host country or region. For more Chinese enterprises to expand and sustain their overseas operations successfully, collective commitments to conduct business in a responsible manner are crucial.

In this context, international standards as those reflected in the OECD *Guidelines for Multinational Enterprises* (the *Guidelines*)⁷⁶ can be particularly useful in providing a common frame of reference for enterprises to ensure that their operations are compatible with the expectations of host countries. The *Guidelines* can also serve as a tool for interpreting the meaning and guiding the application of other international instruments and domestic laws.

Adoption of voluntary codes of environmentally responsible conduct reflecting international standards such as the *Guidelines* can reassure a public which is growing anxious about Chinese enterprises' business models, intentions and impacts on the environment. By encouraging enterprises to observe such voluntary codes, the government may maintain a country's reputation as a good business partner and investor in international markets and may avoid some of the costs of making and applying formal regulations. By adhering to the OECD Declaration on International Investment and Multinational Enterprises, the government can demonstrate its commitment to promote the *Guidelines* among enterprises of its nationality or operated in its territory down to the end of their supply chain, and benefit from the specific implementation mechanism available through National Contact Points (NCPs).⁷⁷ Finally, implementation of these voluntary codes by enterprises can contribute to poverty reduction and sustainable development.

Notes

1. Examples include *Guidance on Central Government Owned Enterprises Fulfilling Social Responsibilities* and *Guidelines on Sustainable Management of Overseas Forests for Chinese Enterprises*.
2. The concept of "harmonious society" was first introduced at the Fourth Plenary Session of the 16th Communist Party of China Central Committee in 2004 as the ultimate goal. It aims to achieve a balance between economic growth, social equity and environmental protection.
3. The "scientific concept of development" was also initiated by the 16th Communist Party of China Central Committee as the major strategic concept guiding China's economic and social development and socialist modernisation. It calls for people-centred development that is comprehensive, balanced and sustainable.
4. Ministry of Environmental Protection (2008), *The State of the Environment of China 2007*.

5. Background material for this chapter was provided in a report prepared for the OECD by the Global Environment Institute: *Chinese government approaches to encouraging environmentally responsible business conduct* (2008).
6. The formal EPL came into effect in 1989 and now constitutes the main legal basis for China's environmental protection system. The EPL established the basic principle for co-ordinated development between economic growth, social progress and environmental protection, and defined the rights and duties of governments at all levels and other agents with regards to environmental protection.
7. The Fourth National Conference on Environmental Protection in 1996 was the turning point in the reform of environmental policies in China as it described explicit environmental objectives, duties and plans, and for the first time placed pollution control and ecological conservation as two major tasks.
8. The Cleaner Production (CP) Promotion Law was enacted in June 2002 (effective since January 2003), requiring full control over the entire production process to reduce pollution. CP is now being promoted by MEP through CP centres set up across the country.
9. The Environmental Impact Assessment Law was enacted in 2002.
10. The Law on Renewable Energy was enacted in 2005.
11. The term "circular economy" denotes an alternative economic growth model that is not based on the intensive use of energy and other primary resources and the generation of waste and pollution. In July 2005, the State Council announced, in *Several Opinions on Accelerating the Development of Circular Economy*, its commitment to make efforts to develop Circular Economy. Following this policy statement, the draft Law on Circular Economy was submitted for deliberation to Standing Committee of NPC in 2007.
12. SASAC (2007), *The Guidance on Fulfilling Social Responsibilities by Central Enterprises*.
13. See Chapter 7, "Environmental-economic Integration of OECD", *EPR China 2007*.
14. The concept of EIA was introduced at the first conference for national environmental protection in 1973 and the first example of an official EIA, for a copper mine, was carried out in 1979. The EPL also provides a legislative basis for EIA, requiring projects with potentially negative environmental effects to be subject to environmental impact assessment. EIA was made compulsory for all construction projects under the *Ordinance of Environmental Management for Construction Projects* 1998. The EIA law 2002 further strengthened the legal status of EIA in China and improved effectiveness of the EIA system.
15. However, the statistics published by SEPA may be misleading since agencies conducting assessment are known to falsify EIA reports to obtain approval.
16. SEPA (February 2006), *the Provisional Measures for Public Participation in EIA*.
17. See Chapter 4, "Water management of OECD", *EPR China 2007*.
18. See Chapter 7, "Environmental-economic Integration of OECD", *EPR China 2007*.
19. SEPA, PBOC and CBRC (July 2007), *Opinions on Implementing Environmental Protection Policies and Rules and Preventing Credit Risk*.
20. The Industrial and Commercial Bank of China (ICBC) took the lead in issuing its own green credit policy in September 2007, refusing to lend to projects not in compliance with environmental policies. It also formed a database for the clients'

environmental risks. The China Export Import Bank also released a code of environmental conduct in 2007.

21. SEPA and CIRC (2007), *Guiding Opinions on Environmental Pollution Liability Insurance*.
22. For example, the then SEPA handled 108 major environmental incidents, an average of one in every two days, in 2007.
23. SEPA (February 2008), *Guide to Strengthening Environmental Regulation on Listed Companies*. Shenzhen Stock Exchange published its own set of social and environmental instructions for listed companies in 2006 (see Chapter 4, Annex 4.A2).
24. The thirteen industries include thermal power generation, iron and steel, cement, electrolytic aluminium, and high energy consumption and high pollution industries.
25. According to *Circular on Further Regulating Environmental Review of Production and Trading Companies Involved in Heavy Pollution Industries for IPO or Refinancing* issued by SEPA in 2007.
26. SEPA and MOFCOM (2007), *Circular on Enhancing Environmental Monitoring over Export Enterprises*.
27. For more information, see Chapter 1.
28. Article 124 states that any person who pollutes the environment and causes damage to others in violation of state provisions for environmental protection and the prevention of pollution shall bear civil liability in accordance with the law.
29. Article 41 states that a unit that has caused an environmental pollution hazard shall have the obligation to eliminate it and make compensations to the unit or individual that suffered direct losses.
30. For example, the 2008 amendment to the *Law on Prevention and Control of Water Pollution* raised the liability of corporate executives for causing serious water pollution who previously faced only administrative penalties. Under the amended law, corporate executives and others responsible for causing severe water pollution incidents will be fined up to half of their income of the previous year.
31. These selected cities and development zones were given 3 months to address pollution problems during which no permission would be given to new industrial projects regardless of pollution levels.
32. See Chapter 7, “Environmental-economic Integration of OECD”, *EPR China 2007*.
33. Appointment of heads of sub-national EPBs must now be endorsed by a higher-ranking environmental administration and lower-level EPBs have been given independent administrative status.
34. This is often the case, since: i) local government leaders’ awareness of environmental values is still low; ii) the promotion criteria for local government officials have been based on performance in narrowly defined economic development and employment creation; iii) polluting firms may constitute vital revenue sources for local governments; and iv) village and township enterprises may have a very close connection with local government in regard to tax, employment and personal links.
35. In 2008 SEPA was elevated to the full status of ministry as the MEP and given full membership in the State Council (China’s cabinet). Furthermore, an environmental protection team was established at the State Council under the direct leadership of the Premier with a Secretariat set up within the MEP. This

institutional progress is expected to facilitate co-ordination of environmental and other policies, maximise synergies between the work of different bodies and reduce overlaps and contradictions.

36. For the case for encouraging responsible business conduct in general, see Chapter 4.
37. Many multinationals are adopting environmental policies that extend through their supply chains in the form of requirements for suppliers to adhere to sustainability certifications such as ISO 14001.
38. For the linkage between environmental efforts and innovation, see Chapter 4.
39. The survey was sponsored by China Council for International Cooperation on Environment and Development, Environmental Defence (US) and GTZ (Germany) [Lu, X., D. Dudek and Q. Hu (2006), *Survey of China's environmental law enforcement capacity building and problem analysis*].
40. While China's energy intensity is now comparable to the most energy-intensive OECD countries, the overall material intensity of China's economy is higher than that in OECD countries (OECD, *EPR China 2007*).
41. ISO 14001 is the most popular standards internationally for EMS. The European Union has also developed Eco-Management and Audit Scheme. There are sector-specific EMSs such as the Responsible Care for the chemical sector and UNEP's Finance initiative and the "Equator Principles" for the finance sector.
42. Such standards include the Sustainable Reporting Guidelines by the Global Reporting Initiative, AA1000 Assurance Standard by AccountAbility, and ISO 14063 (still in draft).
43. Such codes include the Coalition for Environmentally Responsible Economies Principles, the OECD Guiding Principles for Chemical Accident, Prevention, Preparedness and Response, and the Responsible Care.
44. For the general characteristics of Chinese companies' sustainability reports, see Chapter 4.
45. By 2004, the number of certified companies in China reached over 8 000, which is the second highest number after Japan.
46. Xiao, S. and W. Hu (2004), *Environmental Information Release of Chinese Listed Companies*, Journal of Beijing Institute of Technology 10, Vol. 6, No. 5, Beijing.
47. <http://english.cbcsd.org.cn>.
48. Examples are China interior decoration association's self-regulation in environmental protection 2007, China rubber industry association's guidelines on recycling waste rubber 2007, China plastic recycle industry self-regulation in Guangzhou 2007, and China coal industry's self-regulation 2009.
49. Enterprise A, (2008), *Corporate Social Responsibility Report 2007*.
50. These three regional companies have a total of 327 Chinese and foreign HSE professionals.
51. Enterprise B (2006), *Sustainable Development Annual Report 2006*.
52. With the new technology in sulphuric acid production, using elemental sulphur as the feedstock, the converted plant could reduce CO₂ emission, air pollutants, wastewater, and solid waste significantly, and at the same time could improve its operating efficiency by over 20%.

53. This alliance formed joint ventures to construct and operate coal gasification plants using enterprise B's technology that allows more efficient use of coal and lower environmental impact than plants using the traditional technology.
54. See Chapter 4.
55. The government is introducing measures to change the performance criteria for government and party officials as well as managers of SOEs so that their career prospects will be linked to their performance in achieving environmental goals.
56. See Chapter 8 on the environmental-social interface of OECD of *EPR China 2007*.
57. It promised perfecting a social supervision mechanism for environmental protection.
58. It requires administration agencies to inform citizens of their right to express their opinions at public hearings regarding any government projects that might have an impact on them.
59. SEPA (2004), *Provisional Measures for Environmental Protection Administrative Licensing Hearings* and *Provisional Measures for Public Participation in Environmental Impact Assessment*.
60. Registration of an NGO in China requires sponsorship from a government agent and no two groups can be registered for the same kind of work within the same city or province.
61. An example of successful campaign by civil society groups against a polluting project is described in Chapter 4.
62. Chapter 4 of this *Review* includes discussion on the overall government framework of laws and regulations requiring financial and non-financial disclosure by enterprises about their business activities.
63. The 1996 Decision by the State Council on Certain Environmental Issues strongly encouraged the media and citizens to expose illegal actions that cause environmental damage.
64. SEPA (2007), *the Measures for the Disclosure of Environmental Information*.
65. Incentives may include publicity on local media and priority given in allocation of various environment protection funds and subsidies administered by the government.
66. See Chapter 8, "Environmental-social Interface of OECD" of *EPR China 2007*.
67. A small but growing number of environmental NGOs and lawyers provide legal representation in environmental litigation. Notable examples include Centre for Legal Assistance for Pollution Victims (CLAPV) and Green Earth Volunteers.
68. OECD (2007a) contains general discussion on the evolution of China's legal system.
69. The government is also encouraging enterprises to obtain ISO 14001 certification. For example, the government made the certification a prerequisite for setting up a unit in certain economic development zones, high-tech development zones and scenic areas which were designated as national demonstration areas.
70. SEPA (2005), *Opinions on Accelerating the Evaluation of Corporate Environmental Behaviour*.
71. www.cciced.org.

72. Issued by the State Council in October 2007, it called on Chinese investors to fulfil the necessary social responsibility to protect the legitimate rights and interests of local employees, pay attention to environmental resource protection, care and support of the local community and people's livelihood and to preserve our good image and a good corporate reputation.
73. This is intended to provide industrial standards and self-disciplinary criteria for Chinese enterprises engaged in forestry activities overseas.
74. Chapter 9, "International Co-operation of OECD" of *EPR China 2007*.
75. For more discussion, see Chapter 3 of the *2008 Investment Policy Review of China* (draft).
76. The *Guidelines* have been adopted by 41 governments to date. Chapter 5 on environment refers to general standards of environmental protection and provides a list of specific tools for fulfilling corporate environmental responsibility such as environment management systems, life-cycle assessment and EIA, contribution to the development of environmentally meaningful and economically efficient public policies, risk prevention and mitigation, communication of information on environmental impacts to the public through environmental reporting and eco-labeling and through consultation with communities.
77. The NCP is a government office responsible for encouraging observance of the *Guidelines* in a national context and for ensuring that the *Guidelines* are well known and understood by the national business community and by other interested parties. The NCP gathers information on national experiences with the *Guidelines*, handles enquiries, discusses matters related to the *Guidelines* and assists in solving problems that may arise in this connection. Setting up the NCP is an obligation of each adhering government.

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ANNEX 5.A1

*A List of Environmental Laws,
Regulations and Policies in China*

List of environmental laws, regulations and policies in China

	Date	Issued by
Environmental Protection Law (trial until 1989, amended in 2001)	1979	NPC
Law on Prevention and Control of Water Pollution (amended in 1996)	1984	NPC
Law on Prevention and Control of Environmental Pollution by Solid Waste (amended in 2004)	1995	NPC
Law on Prevention and Control of Air Pollution (amended in 2000 and 2002)	1995	NPC
Decision on Certain Environmental Issues	1996	SC
Law on Energy Conservation (amended in 2007)	1997	NPC
Cleaner Production Promotion Law (amended in 2003)	1998	NPC
Environment Impact Assessment Law	2002	NPC
Law on Administrative Permission	2003	NPC
Provisional Measures for Environmental Protection Administrative Licensing Hearings	2004	SEPA
Provisional Measures for Public Participation in Environmental Impact Assessment	2004	SEPA
Decision on Implementing Scientific Concept of Development and Strengthening Environmental Protection	2005	SC
Several Opinions on Accelerating the Development of Circular Economy	2005	SC
Opinions on Accelerating the Evaluation of Corporate Environmental Behaviour	2005	SEPA
Law on Renewable Energy	2005	NPC
Interim Provisions on the Punishment of Violations of Environmental Protection Laws and Regulations	2006	Ministry of Supervision, SEPA
Provisional Measures of Public Participation in EIA	2006	SEPA
Opinions on Implementing Environmental Protection Policies and Rules and Preventing Credit Risk (green credit policy)	2007	SEPA, PBC, CBRC
Guiding Opinions on Environmental Pollution Liability Insurance (green insurance policy)	2007	SEPA, CIRC
Measures for the Disclosure of Environmental Information (trial implementation)	2007	SEPA
Guidance on Central Government Owned Enterprises Fulfilling Social Responsibilities	2007	SASAC
Guidelines on Sustainable Management of Overseas Forests for Chinese Enterprises	2007	SEPA, State Forestry Department
Nine Principles on Encouraging and Standardising Foreign Investment	2007	SC
Circular on Further Regulating Environmental Review of Production and Trading Companies Involved in Heavy Pollution Industries for IPO or Refinancing	2007	SEPA
Circular on Enhancing the Environmental Monitoring over Export Enterprises	2007	SEPA, MOFCOM
Guide to Strengthen Environmental Regulation on Listed Companies (green security policy)	2008	SEPA

CBRC = China Banking Regulatory Commission; CIRC = China Insurance Regulatory Commission; MOFCOM = Ministry of Commerce; NPC = National People's Congress; PBC = People's Bank of China; SASAC = State-owned Assets Supervision and Administration Commission; SC = State Council; SEPA = State Environment Protection Administration, since renamed the Ministry of Environmental Protection.