

China environmental policies development and trends for the year 2018

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Introduction

In recent decades, China has seen unparalleled economic growth. Most of the developed countries like Britain, the United States and Japan have all gone through periods of enormously rapid industrial growth. Many of them encountered the problem of pollution and had to develop measures to solve those issues and clean up the aftermath. China is going through an industrial revolution of its own, which is on the one hand happening in more compressed time frames than other great powers in the history, but at the same time, it also got pollution on a scale that has never been seen before. Over the past 30 years China has been favoring creating economic growth over environmental protection. The parties became somehow fixated on producing ever higher economic growth. As a result of the breakneck industrialization and urbanization, with average GDP growth of 10 percent each year for more than a decade, China is now suffering from air pollution, desertification, loss of biodiversity, and water pollution.

Hazardous levels of water and air pollutants have become a daily phenomenon in the lives of the Chinese people. Nowadays China is the world's largest emitter of greenhouse gases, having overtaken the United States in 2007, and was responsible for almost 30 per cent of world emissions in 2017. According to the United Nations report, in 2013 life expectancy north of the Huai River was 5.5 years lower than in the south due to air pollution (life expectancy in China is 75.3 years). A 2016 report published by Ministry of Environmental Protection The People's Republic of China states that out of 338 cities across the country, 254 cities failed to meet national small-particle pollution standards (national air quality), which is 75% of all cities in the country. Air pollution has attracted public concern because of its harmful effects on health. In China today, air pollution kills an estimated 1.1 million people a year, according to a study published by the U.S.-based Health Effects Institute.¹ Furthermore, pollution is exerting a serious impact on the economic situation of the country. Premature deaths and health problems from air pollution alone cost China as much as \$US300 billion a year (Greenpeace, 2015).

Experts also cite water depletion and pollution as among the country's biggest environmental challenges. China is home to 20 percent of the world's population but only 7 percent of its fresh water sources. Due to overuse and contamination approximately two-thirds of China's cities suffer from water shortages and more than 60 percent of groundwater supplies in China major cities were categorized as "bad to very bad" in 2014. According to China's State Forestry Administration, about 1.05 million square miles of China's landmass are undergoing desertification, affecting more than 400 million people.

¹ <http://www.scmp.com/news/china/policies-politics/article/2119803/china-helping-push-carbon-emissions-all-time-high>

Environmental degradation threatens to undermine the country's growth and endangers domestic stability as there is a lot of public discontent with the situation. Also now China is confronting a situation when pollution is not merely a domestic issue, it is an international issue. Chinese experts and international experts have realized there has not been enough focus on the environmental costs of that growth. Everyone knows that pollution is a serious issue, and if you can calculate into the GDP, that gives you a real picture of the true cost of economic growth. The country's leadership has realized that quality of life is just as important as the material benefits of GDP and job creation.

Background

The government showed the change of course and increasing determination to tackle the problem of air pollution especially after an acute episode of bad air quality over Beijing or so called "airpocalypse" in January 2013. In 2013, China rolled out a plan to reduce its notorious air pollution within five years issuing a set of prohibitions called the national action plan on air pollution. These changes came largely in recognition that past policies were not effective enough to curb activities contributing to air pollution. The plan imposed a nationwide cap on coal use, banned new coal-burning capacity and sped up the use of filters and scrubbers. The measures were outright bans on polluting activities, rather than incentives to clean up production, such as prices or taxes.

In 2014, Chinese Premier Li Keqiang declared a "war on pollution", and in May of the same year the Chinese Government tightened the Environmental Protection Law (EPL), with substantial changes to become effective as of January 2015. In a November 2014 joint statement on climate change with the United States, China committed to hit its peak carbon emissions by 2030 and to have renewables account for 20 percent of its energy mix by 2030. China, once reluctant to take a stand on environmental issues and climate change, emerged as a leader in negotiations at the 2015 UN Climate Conference in Paris where 195 countries signed a breakthrough accord.

Levels of fine-particulate pollution in the Beijing region had fallen by more than 25 percent in 2014 and 2015, as initial cuts bore fruit, but in late 2016 and early 2017 they spiked again.

In 2016, the Ministry of Environmental Protection set up the Central Environmental Protection Inspection to monitor the local implementation of environmental laws and policies in heavy industries. It used to be the case that the cost of complying with Environmental Protection Law was higher than the fines one would be given for non-compliance. Since 2016 this is no longer the case.

As a result of the anti-pollution inspections in China, by the end of 2017, around 40 percent of polluting companies were punished, fines of 870 million yuan (\$\$180 million) issued and more than 12,000 officials disciplined. Also, more than 80,000 factories were shut down across China by the anti-pollution drive by December 2017. The sectors most severely targeted were textiles, energy, heavy metals, coal and gas, mining, cement, paper, automobile, and consumer goods. In September 2017, China also began halving steel production in key manufacturing hubs and asked producers to cut 30% of their coking coal production. These measures appear to be paying off: By the

end of last year, according to government sources, China seemed to have met all the major targets in its 2013 action plan. However, the changes are coming at the expense of economic growth, which has dropped from above 10% in 2010 to below 7% in recent years. Stricter implementation of environmental regulations led to tighter supplies and in turn lifted prices that have to be absorbed by the consumer, as well as inflation spike, loss of more than 60,000 jobs as a result of factory shutdowns and close down of small-scale firms that are unable to compete in the new requirements. It is anticipated that the firms that manage to survive and adapt to the new environmental regulations will significantly benefit in the medium run as they will gain the market share previously held by smaller firms. In short, China's measures work, but at a cost.

2018 Developments

There is no doubt that today the central government is very serious about improving the environmental situation in China. In comparison to his predecessors, President Xi Jinping has emphasized environmental progress as a central component of his overall policy platform. During the 19th Party Congress in October 2017, Xi referenced the environment more times than the economy (89 mentions to 70) and laid out a vision for cleaner air and water, more efficient energy use, and global leadership on climate change. Rapid concentration of power under President Xi Jinping definitely facilitates a more efficient transition to a greener economy. At the beginning of 2018 China took a number of new steps in its transition from the world's top polluter to global leader in the fight against pollution and climate change.

At the March 5 release of the 2018 Government Work Plan, Chinese Premier Li Keqiang [called](#) for closing inefficient coal and steel plants, increasing China's electric car fleet, banning waste imports, and hardening pollution standards and enforcement.

On March 13, China announced its most significant environmental governance reforms of this decade. The State Council presented draft plans to consolidate major responsibilities in environmental policymaking currently spread throughout different agencies in the newly formed Ministry of Ecological Environment. This will allow Current MEP Vice Minister Huang Runqiu claims these changes will solve an "accountability and ownership gap" among disparate agencies and streamline overlapping functions by removing policy making bottlenecks. This new ministry will become the most powerful dedicated environmental regulatory body in the history of modern China. While coordination problems will not completely disappear with China's ministerial consolidation, the new Ministry of Ecological Environment will deploy enforcement staff across the country, and be the instrument for applying China's centralized environmental statutes. The Ministry of Ecological Environment will work with the newly formed Ministry of Natural Resources and Ministry of Emergency Management, the NDRC, and others to create coherent and effective policies.

Apart from the governance reforms and the stronger enforcement of pre-existing environmental rules, China has implemented new environmental regulations and taxes that came into effect this year. I would like to focus on the two elements that will have the biggest effect in the long run.

The first one is China's ban on 24 types of waste, which came into effect at the end of last year as part of a campaign against "foreign garbage".

The ban was announced by five government agencies in July and went into effect on December 31, 2017. It affects several classes of waste including waste plastic, glass, slag, waste wool, ash, cotton, yarn, and unsorted paper.

The ban has already affected both overseas exporters of waste and China-based purchasers of waste, as well as companies who purchase raw materials made from reprocessed waste.

Many developed countries depend on Chinese demand to handle their excess waste, which Chinese recyclers purchase, sort, process, and subsequently re-sell. As a result of the ban, prices of materials like paper and plastic have skyrocketed, driving up costs for businesses reliant on cheap recycled goods.

China's industrial boom helped spur the growth of its immense recycling industry, as recyclers provided manufacturers with cheap materials to produce their goods. The appetite for raw materials from the manufacturing sector led China to become the world's largest importer of foreign waste.

Last year, China imported over US\$18 billion worth of waste, mostly coming from developed countries such as the US and Japan. It imported 7.3 million metric tons of waste plastics alone, representing 56 percent of the world total, valued at US\$3.7 billion.

According to the Wall Street Journal, in 2016 over two-thirds of the US' waste paper exports and over 40 percent of its discarded plastic exports were sent to China, while paper and plastic scrap exports to China were worth over US\$2.2 billion. The EU27 is similarly dependent on China to take its waste, as it sends 87 percent of its recycled plastic directly or indirectly to China.

Chinese recyclers reprocess waste to make a wide range of usable materials for re-selling, such as cardboard and yarn. Businesses – both domestic and overseas – purchase these goods at an affordable rate, and are also able to market their use of recycled materials.

However, while businesses tend to tout their environmentalism by using such materials, the recycling process itself can be highly polluting within China.

The country's recycling industry is highly decentralized and poorly regulated. Workers in the industry rarely take safety precautions – or even have access to proper equipment and supplies – to handle waste that is often contaminated with hazardous substances. Further, recyclers often discard unrecyclable waste into landfills or bodies of water, or simply have it incinerated.

Such practices are highly polluting and create health hazards for the local population.

As China seeks to address its myriad environmental challenges, including air pollution and water contamination, it is banning the import of waste that can cause environmental issues at home.

In this regards, environment minister Li Ganjie maintained that "All countries must deal with their own generation of hazardous waste, reduce this on their own, and process this on their own; only with this understanding... can we build a clean and beautiful world,"

Effects on businesses & investors:

The ban on imported waste will have far-reaching effects, both within China and abroad.

In the short-term, prices of recycled goods have plummeted as collectors desperately seek new buyers, while waste inventories are immobile and piling up. For example, Hong Kong's waste paper collection points have reportedly become overloaded since the ban was announced, while cargo ships loaded with paper meant for recycling have been stuck in port with no destination.

In the long-term, manufacturers in China will face higher costs for materials as they buy from other sources. Many manufacturers may have to make up for the shortfall in plastics, for instance, by purchasing from petrochemical companies.

Meanwhile, waste collectors may have to store their waste until they can find new markets. Developed countries that are used to exporting their waste now face a more pressing need to develop technology that makes waste sorting more efficient and reduces contamination levels.

The ban is not China's first attempt to regulate the industry. In 2011, the Ministry of Environmental Protection issued regulations on the import of foreign waste, but its implementation was questionable. Most notably, Operation Green Fence, which environmental authorities launched in 2013, sought to curb imports of low quality waste.

China has instituted the latest ban in tandem with an inspection campaign within the industry. Through the first two weeks of the campaign, from July 1 to July 14, regulators inspected 888 plastic recycling factories. Of those, 590 violated certain rules, 383 had their production suspended, and 53 were shut down.

Chinese President Xi Jinping recently announced his goals for China to become a leader in pursuing "ecological civilization". As China continues to modernize its industrial processes and combat its vast environmental problems, more stringent regulation of polluters – and possibly additional bans on waste imports – is likely.

The second element I would like to focus on is the implementation of a new environmental tax policy, which came into effect on January 1, 2018. The new tax is replacing the pollutant discharge fee that had been in effect for the past 40 years.

While the ultimate impact that the tax will have in addressing China's pollution issues is unclear, businesses in the country should prepare themselves for more stringent enforcement of both new and existing environmental laws and regulations.

The Environmental Protection Tax applies to the same four categories as the pollutant discharge fee that it is effectively replacing: water pollution, air pollution, noise pollution, and solid wastes.

What differentiates the new tax from the fee is that all of the revenue collected will be retained at the local level. Previously, the central government took 10 percent of the fee. Now, local authorities collect 100 percent of the tax revenue and have more power to enforce the tax.

The Environmental Protection Tax also provides more nuance than the fee system. The fee system made no distinction between light and heavy polluters, meaning that firms had no incentive to cut down on their emissions as they had to pay a uniform fee regardless. In contrast, the Environmental Protection Tax applies different tax rates depending on the level of pollution, which means that heavy polluters will have to pay more than light polluters.

Similarly, the tax system offers more attainable tax reductions as an incentive to curtail emissions. Previously, there was only one way to reduce the fee payable, namely a 50 percent fee reduction if the firm polluted at least 50 percent less than the local standard. Now, in addition to the 50 percent reduction, firms that pollute 30 to 49 percent less than the standard receive a 25 percent tax reduction.

Further, the penalty for not paying the tax is more serious. Under the fee system, failure to pay could result in a fine of up to three times the fee. Under the tax system, failure to pay can result in a fine up to five times the tax, and criminal penalties can be brought forward for egregious offenders.

The move from a fee to a tax scheme is also meant to close loopholes often exploited by the local governments, which often overlooked the most serious offenders in favor of collecting higher fiscal revenues. However, local authorities have also been given a certain amount of discretion. They can decide what tax rate is applicable for each kind of pollutant, within a range presented by the central government. This flexibility allows for governments to consider the local socioeconomic context and the polluting enterprise's situation.

Taken together, local governments should be more willing to enforce the law and punish polluting firms, while companies will also have greater incentives to "green" their production.

Effects on businesses & investors:

Companies involved in pollution-intensive industries such as manufacturing should expect an overall rise of the cost of doing business. However, the magnitude of the impact will depend on where the firm is located. The fact that the pollution tax rates are decided at the provincial level, since each province is subject to different socioeconomic conditions, could result in the migration of polluting agents to the more tax friendly regions of the country.

Because of this issue, regions with large manufacturing bases may set their tax rates lower to retain the fiscal revenue. Some local governments have already released their tax rates, with Beijing – under pressure from the central government to improve its environment – applying the highest rate on emissions. In contrast, Guangdong, China's traditional manufacturing hub, will remain an attractive location for manufacturing investment as the pollution taxes there are currently set at relatively low rates.

Investors should expect further moves in environmental law enforcement, albeit in a gradual fashion as local governments balance demands for economic growth and environmental concerns. Given the trajectory of environmental law enforcement in China, businesses are advised to adopt more sustainable production methods and comply with pollution regulations regardless of their location in the country.

A good example of President Xi's new paradigm and how far local government attitudes toward development have changed is the case of mighty packaging company Tetra Pak. When it wanted to set establish itself in southern China 26 years ago, the Foshan city government offered a plot on a new industrial park a few miles out of town. Tetra Pak thrived. At one point, it had a 90 percent share of China's beverage paper packaging market and was for many years Foshan's largest taxpayer.

But as Foshan grew, Tetra Pak's factory, which was once out-of-town, became swallowed by urban sprawl and surrounded by residents worried about air pollution. Last fall, after years of lobbying by angry locals – and a \$100 million antitrust fine in 2016 – Tetra Pak transferred production to factories in Hohhot, Kunshan, and Beijing.

The wave of enforcement and new regulations makes no distinction between foreign and Chinese corporations. It set the phones ringing at China's foreign commercial chambers and other professional organizations with calls from affected firms calling for member events to share experiences and recommendations. Corporations have also started performing more internal environmental audits to gain a greater level of comfort in the new environment. Others have started screening their suppliers to better understand their indirect vulnerability.

Most efforts so far have targeted air and water discharge pollution, with soil and groundwater contamination – the most insidious of all pollution – being the main focus of the Chinese authorities.

As the consequences of environmental contamination become quantifiable and acknowledged by the new environmental courts, companies will begin to seek apportioning liability. This will lead to the growth of environmental insurance products and promote the use of environmental technologies.

How should businesses & investors react to the new environmental regulations?

To adjust to the new environment, companies should work with environmental assessors and legal counsel to audit themselves. This can guard against the following red flags that will be picked up in an investigatory visit by environmental officials:

- Absent or incomplete Environment, Health & Safety permits
- Non-compliance with land use or industrial policy
- Inadequate environmental protection facilities
- Hazardous waste disposal by unlicensed parties
- Any soil or ground water contamination
- Outstanding fees or fines
- Disputes with neighboring residents or facilities

- Occupational health or safety compensation issues
- Exposure by media or non-governmental organizations for non-compliance

I personally believe that the current rigor in environmental enforcement is likely to prevail. Proactive self-assessment, combined with a strong compliance policy, is the best way for businesses to guard against nasty surprises, and to have a ready defense demonstrating robust environmental compliance policies. Many of the initiatives mentioned are going to open up vast numbers of opportunities for firms to bring their solutions to the China market, and actors must be well-placed to capitalize and fill gaps in services that the society and market require.

By initiating an era in which environmental enforcement is the “new normal,” China will be making a massive contribution to improving ecosystems far beyond its own borders. Western investors will mostly weather the inconvenience and emerge from the initial investigatory shock in a stronger market position and better able to compete on their own terms.