



# China's Reds Embrace Green

by Zhang Zhongxiang

**P**RESIDENT HU JINTAO and Prime Minister Wen Jiabao have recognized the seriousness of environmental degradation in China, and accordingly insist that the conventional Chinese path of encouraging economic growth at the expense of the environment has to be changed. As a first but most important step to clean up the country's development act, Messrs. Hu and Wen incorporated for the first time energy-saving and environmental goals into the national five-year economic blueprint for China. This could be a double-edged sword. It clearly distinguishes their vision of China's development from that of their predecessors, but this is a test of their leadership. Last year's results were disappointing, but encouraging signs are now being seen.

In March of this year, Mr. Wen told the delegates at the annual session of the National People's Congress that the government missed its goals last year of cutting energy use per unit of GDP by 4%, and reducing emissions of major pollutants by 2%. That should come as no surprise. It is almost impossible to achieve stringent en-

ergy-saving and environmental targets when officials' promotions are largely based on increased economic performance, especially in the year running up to the Central Committee meeting, which takes place once every four years and is scheduled to meet this fall.

While China achieved a 1.23% decrease in energy intensity over the entire year last year, this decline—the first since 2003—is far short of the target of 4%. Last year, sulfur dioxide (SO<sub>2</sub>) emissions rose by 1.8%, and chemical oxygen demand (COD), a water pollution index, increased by 1.2%. The Chinese government did slow down the growth of these pollutants significantly—the growth rates of SO<sub>2</sub> emissions and COD last year being 11.3% and 4.4% less than that in 2005, respectively—but still missed the goal of reducing these emissions by 2% as a part of an ambitious plan to cut emissions by 10% in the period 2006-10.

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People stand as smoke billows out of a power plant in Baotou, Inner Mongolia. The Chinese government is struggling to curb pollution.

This slowdown in pollutant growth is a result of concerted efforts the Chinese government took to meet its goals last year. Due to enforcement of the environmental impact assessment (EIA) law alone, 163 proposed projects worth 774.6 billion yuan (around \$100 billion) were put on hold. Empowered by the State Council, the powerful National Development and Reform Commission signed energy-saving responsibility agreements with 30 provincial governments and 14 central state-owned corporations. Similarly, the State Environmental Protection Agency (SEPA) signed SO<sub>2</sub>-cutting responsibility agreements with seven provincial governments and six top national power-generating groups, which together account for two-thirds of the country's total SO<sub>2</sub> emissions.

Despite these efforts, China failed to meet the set goals. This failure was in part due to the government being overly optimistic. The annual targets were only set in March last year and the enforcement efforts to meet the goals were unveiled afterward. It takes time for such measures to take effect, but this was not adequately taken into account. More importantly, China's economy grew at a much higher rate than planned. The goals of energy-saving and emissions reductions were based on a GDP growth rate of 8%, but GDP actually grew by 10.7%. Highly polluting and energy-intensive industries grew at

even a faster rate.

For quite some time, China has valued economic growth above environmental protection, and has taken economic growth as the predominate criteria for evaluating local officials' performances. This past year was no exception. And customarily during the year running up to a Central Committee meeting, local officials push for high economic growth in their regions by pursuing projects that can achieve quick, short-term results. Higher economic growth traditionally has helped boost the local officials' promotion prospects as their economic performances are weighted higher than other factors, despite growing calls for incorporating environmental performance into their overall evaluation.

Failure to meet the energy-saving and environmental goals last year, however, has put China in a difficult position. Looking at current trends, it seems very unlikely that China will meet its goals for this year. That would make it very difficult that the goals incorporated for the first time in the country's five-year plan running from 2006 to 2010 will be met.

That would deal a blow to the images of President Hu and Prime Minister Wen, who have made building a "harmonious society" through "scientific development" the guiding principle of development, the principle that is about to be elevated by the Communist Party this fall to the same level as Mao Zedong Thought and Deng Xiaoping Theory. As Messrs. Hu and Wen both position themselves for another term in office, falling short on these goals will hurt their credibility and ability to run the country.

## Tough Choices

THE QUESTION THEN is whether there are ways out of this potential crisis. In my view, the two top Chinese leaders face daunting challenges ahead, but time has

not yet run out. They still have options, although implementation will not be easy.

Fundamentally, the central government must change China's currently energy-inefficient and environmentally unfriendly pattern of economic growth. To that end, the government needs to get resource-pricing right to properly reflect resource scarcities and the costs of pollution and to improve financial, taxation and legal system in order to encourage energy saving, environmental protection and development of renewable energies.

The prices of energy resources have been kept low in China, and may only reflect the cost of production. Certainly they reflect neither the situation of supply and demand on the market, nor the scarcity of resources. They also do not incorporate externalities such as environmental and health impacts. This has led to inefficient production and use of resources, and creates no incentive for energy conservation. Policies need to be implemented to shut down plants that are inefficient and highly polluting, and keep the frenzied expansion of offending industries under control.

Local officials will strongly resist, no doubt, because these companies provide jobs and create tax revenues as well as personal payoffs. Forcing companies out of business could even trigger local unrest. As an example, last September the NDRC, China's top economic planning agency, ordered provincial governments to raise power tariffs for eight energy-guzzling industries including cement, aluminum, iron and steel, and ferroalloy. However it is reported that by mid-April this year, not only had many local governments failed to implement the differentiated tariffs that charge more for companies classified as "eliminated types" or "restrained types" in these industries, but 14 of them even continued to offer preferential power tariffs for such industries.

So, while the central government is convinced of the need to clean up the country's environmental act, as always in China, what the center wants isn't necessarily what the center gets. An old saying goes, "The mountains are high, and the emperor is far away." Clearly, the central government needs local officials' cooperation to get these policies implemented.

To gain local officials' cooperation on the environmental issues, incentives need to be provided. The economic reforms over the past 27 years in China have shifted control over resources and decision-making to local governments. This devolution of decision-making to local levels has placed environmental stewardship in the hands of local officials who are more concerned with economic growth than the environment.

Instead, in evaluating local officials' performances, work in the area of environmental protection should also be considered. If environmental quality does not improve during the official's tenure, that official should not be promoted. This will help the local officials realize that they have a very real stake in meeting environmental goals. To this end, the central government has been using a variety of the tactics to incentivize local governments. Starting in 1997, the SEPA has run a model environmental city program. Any city that meets 28 different SEPA-specified environmental indicators is awarded the title. Out of 661 cities in China, about 50 have been placed on the honor roll to date.

To further push local governments on the environmental front, for the first time the SEPA announced its blacklist of the 10 most polluted cities on July 13, 2004, to discourage environmentally irresponsible decisions. That shocked local officials who had always worked on the assumption that evil deeds very seldom see the light of day. This public disclosure works effectively because it puts more pressure on local of-

ficials to take responsibility for the health of their people and to take action.

To help the general public and officials alike to understand how seriously China confronts the rising costs of environmental degradation associated with its rapid economic growth, in March 2004, the SEPA and the National Bureau of Statistics jointly launched a project on Green GDP Accounting Research, trying to incorporate environmental degradation into the accounting of traditional GDP to give a more realistic picture of the health of the economy. In September 2006, they jointly released the first-ever report on the economic costs of pollution. This study estimates that environmental pollution still costs China \$64 billion, or 3.05% of GDP in 2004. The SEPA is also promoting using the calculated green GDP instead of traditional GDP as the economic criterion to evaluate the real performance of local officials.

To further enhance the environmental awareness of local officials, the SEPA should further tighten approval of construction projects by expanding the scope of the so-called regional permit restrictions. While Messrs. Hu and Wen gave the SEPA, which was for years seen as a powerless entity, a new lease on life and elevated it from a lowly vice-ministry rank to full ministerial status, the SEPA still does not have the authority to suspend proposed projects violating environmental laws and regulations or to remove officials who should be held accountable for this non-compliance. It also lacks the authority to manage local environmental bureaus.

In case the SEPA decides to impose a penalty on violators of EIA laws and regulations, the maximum fine at its disposal is just 200,000 yuan (about \$25,000). Even for environmental accidents as serious as the Songhua River spill in November 2005 in Northern China, the incident that had unprecedented international implications as well as domestic social, economic and

environmental ramifications, the maximum fine by China's current environmental laws is just one million yuan, which was actually imposed one year after that incident. Moreover, the fine is only allowed to be imposed once. As a result, this low and one-off penalty is hardly a deterrent to environmental offenders. To make things worse, even these weak punishments empowered by current environmental laws are still weakly enforced in China because of understaffing and inadequate budgets for environmental protection agencies at all levels of the governments.

Given this reality, the SEPA explores administrative measure to change this situation. On January 10 this year, the SEPA made an unprecedented move, suspending EIA approval of any new construction project in four cities (Tangshan, in Hebei province; Luliang, in Shanxi province; Liupanshui, in Guizhou province; and Laiwu, in Shandong province) and four major national power-generating groups until they bring their existing facilities into compliance with environmental regulations.

The so-called regional permit restrictions are based on an ancient Chinese custom of punishing relatives and associates related to the main suspect. Once their EIA approval rights are suspended, no new construction projects are allowed to be built in these cities and by these power-generating groups until all violators are in compliance with environmental regulations. Given that China's economy is investment-driven, local governments are fully aware of the consequences of the suspension of their right to approve new construction projects. To disregard the environmental problems in their regions now can cost them a lot.

In fact, this is not for the first time for the SEPA to impose administrative measures to punish offenders. Since 2005, the SEPA has unleashed a series of environmental protection "storms." Its first-ever storm, unleashed on Jan. 18, 2005, black-

*If Messrs. Hu and Wen fail to achieve these lofty environmental goals, their credibility could be hurt.*

listed 30 industrial projects worth 119.7 billion yuan. Many of these projects were “national key projects” approved by the powerful NDRC, China’s top economic planning agency. While these projects themselves were not necessarily highly polluting, the SEPA called for a halt to these industrial projects on the grounds that they had not undergone proper environmental impact assessments. This first environmental protection storm served as a public-education campaign, increasing the awareness of the EIA law.

In the second environmental storm in 2006, the EIA law was further strengthened, taking it from project level to the deeper level of planning. The use of these regional permit restrictions is the strictest administrative measure ever seen in the SEPA’s 30 years of history.

The underlying reason for suspending EIA approval rights is thought to be the desire to promote technology upgrading, industrial restructuring and sustainable development. Whether it becomes an effective means depends on how local governments and companies succeed in changing their attitudes and practices and whether local environmental protection agencies work together with the national agency. Otherwise, suspending the approval rights only has temporary effects, but does not lead to a long-term efficacy.

Thus far, the new regional permit restrictions seem to be effective. One month after the restrictions suspended approval rights for the four cities, one city, Laiwu, quickly responded to the SEPA warnings and recovered its rights; and only two

months after the suspension, Huaneng Group and China Guodian Corp, the two national power-generating groups, came into compliance and recovered their rights.

Last year, only Beijing, Jiangsu and other four provinces and metropolitan areas met energy-saving and emissions-cutting goals. The SEPA could use its newly asserted power to suspend the right to approve new construction projects in those provinces if they continue noncompliance with the environmental goals.

Increased SEPA power is useful, but the central government should explore other ways to enhance the efficacy of environmental monitoring and compliance. Drawing support of financial institutions is one avenue. From April 1 of this year, SEPA will work with the People’s Bank of China on a new credit-evaluation system under which companies’ environmental compliance records will be incorporated into the bank’s credit-evaluation system. This information will serve as a reference for the bank’s consideration of whether or not to provide loans. The bank could turn down requests for loans from firms with poor environmental records.

I am cautiously optimistic that China will be able to meet these goals. Achieving these objectives could in turn help put the country on a more sustainable development path. If President Hu and Prime Minister Wen can make China “green,” history will record their contribution as equal to Mao Zedong’s achieving China’s independence, and Deng Xiaoping’s creation of a more prosperous country. ■