

JESA INVESTMENT & MANAGEMENT CO. LTD.

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NEWS FROM JESA!

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A wind of change is blowing in East Asia since China, Japan and the Republic of Korea (ROK) met in a trilateral summit in Fukuoka on Friday, December 13th. **It is the first time that the three leading economies of East Asia meet in an autonomous summit and this represents a strong signal for the rest of the world. During the meeting in fact, the basis for an intense financial - economic collaboration was established.**

The issues raised in the summit were not only concerning the global financial crisis, that now appears to be affecting and penetrating also the Asian region, but also they were regarding the begin of a new era in the diplomatic relationships between the three countries. The aim is to enhance a further and continuative collaboration, in order to promote peace, stability and development in the Northeast Asia and in the East Asia regions.

The principles that will drive the cooperation will be "opening, transparency, reciprocal confidence, common interest and respect for the different cultures".



Beside the next annual meetings that are planned to be in China (2009) and Korea (2010), periodical summits between foreign ministers and central bank's governors have also been formalized and scheduled for the next years.

The plan for the trilateral collaboration counts on avoiding any commercial barrier for the next year.

Moreover they want to deepen the studies for a trilateral Free Trade Agreement and to facilitate coordination on investments, logistics and customs policies.

Furthermore there has been a political relevant event: the prime ministers of Japan and China and the president of Korea lunched an **Asian pride statement**, claiming for the region a central role in the global economic growth in order to "let the world economy come back on a sustainable growth path".

This kind of statements and the cooperation planned was unpredictable just few times ago.

We can say that the world financial policies of last years and the crisis surely facilitate this process, but also we have to recognize the pragmatic approach implemented by those three countries: they have been able to put aside the traditional reciprocal grudges. They now seem determined to undertake a stable "future oriented" cooperation.

FDI: THE IMPORTANCE OF THE ENVIRONMENTAL PROTECTION FRAMEWORK

As a consequence of the fast expansion and rapid industrialization China has been increasingly facing stiffer environmental challenges. Over the last few years the Chinese Government has started to focus more and more on environmental and social concerns in order to fight this national emergency in respect to the country's overall interests and long-term development.

The main challenges that need to be faced are related to water shortage, air, water and land pollution, industrial, urban and rural solid wastes, land degradation and energy inefficiency and greenhouse gas emissions. The current situation is drastic. About 300 Mil people have no access to clean water and two third of Chinese cities are facing serious waste water pollution. Close to 70% of the total urban population lives in areas with hazardous air quality and a survey reported that 218 cities out of 530 studied suffer from acid rain precipitation. Soil erosion,

desertification and deforestation have steadily increased lately led by an irrational exploitation of China's natural resources to sustain the economic growth. The expansion of People Republic of China's cities, industries and transport sector have caused an enormous increase in energy consumption, most of it inefficient, and a major increase in greenhouse gas emissions. As a consequence, environmental disputes are rising as well as the common awareness on the ongoing environmental emergency.

In order to react to this pressing urge and to improve and control the current situation, the Chinese Government has been working in recent years to develop, implement and enforce a solid environmental law framework covering almost every area related to the safety of the environment.

The main laws to this regard are the followings:

1. Environmental Protection Law of the People's Republic of China
2. Law of the People's Republic of China on Water and Soil Conservation
3. Law of the People's Republic of China on the

Prevention and Control of Atmospheric Pollution

4. Law of the People's Republic of China on the Prevention and Control of Environmental Pollution by Solid Wastes

This document has the purpose to present a brief understanding and summary of the over reported laws. The intent is to frame a picture of the environmental issues that are needed to be considered by anyone, individual or entity, who's willing to enter China's market and manage its own business.

CHINESE ENVIRONMENTAL LAW FRAMEWORK

As already said, four are the main environmental laws in China of which three are related to specific environment issues and the forth, Environmental Protection Law of the People's Republic of China, is more general.

The **Environmental Protection Law** was adopted in 1989. This law can be considered as a framework containing general references on protecting and improving Chinese environment.

The law stresses the need of a higher attention on safeguarding all the body of natural resources and artificially transformed natural elements by formulating standards on discharge of pollutants, by strengthening the management of environment monitoring through direct observation, scientific approach and on site investigations and by major responsibility on protecting the environment.

It refers to all the aspects of the environment: land, earth, sources of water, soil, rural and urban construction, animals, plants, atmosphere, forests, seas, nature reserve, historic sites and so forth.

Concerning the human and companies' behaviour, the Environmental Protection Law mainly deals with pollutants discharge, damages to natural resources and in particular with the impacts of new construction projects or transformation of existing industrial enterprises, facilities and/or operations that may cause pollution.

In response to the irrational exploitation of natural resources (in particular referring to water wastes and pollution) the **Law on water and Soil conservation** has the aim of avoiding

and/or mitigating soil erosion and encouraging a more rational use of water. The law, adopted on the 29th of June 1991, mainly disciplines activities like industrial productions and constructions project (including also railways, highways and so on) that may cause soil erosion, water pollution and/or any disturbances of vegetation, but it also refers to individuals' behaviour and attitudes in treating and using natural resources.

In the text of the law it's included a section dedicated to the rehabilitation of soil erosion, in which the Government defines the organization of competent administrative departments and units engaged in a planned rehabilitation of the soil erosion through the adoption of water and soil conservation measures.

The **Law on the Prevention and Control of Atmospheric Pollution** dated back to April 29th 2000, treats the huge issue of atmospheric pollution by giving instructions on how prevent and control this phenomenon. The Government stresses the establishing of more frequent and strict controls over likely polluting activities. The law includes some references to the main measures to be adopted for reducing and control

atmospheric pollution, among these some important are: drawing up an environmental impact statement that assesses the atmospheric pollution that a new project is likely to produce (plus accurate and preventive measures); defining national standards for the discharge of atmospheric pollutants; publishing a catalogue of the production techniques and of the equipments which seriously pollute the atmosphere and so are prohibited.

In the law there are also three separate sections each of them related to the three main sources of atmospheric pollution: burning of coal (high sulphur or high ash coal), motor-driven vehicles and vessels and waste gas, dust and fetor.

The **Law on the Prevention and Control of Environmental Pollution by Solid Wastes** was released in 2004 and its objective is to prevent and reduce the discharge amount and harmfulness of solid wastes and to induce a fully and rationally utilization of them. The law is divided in two parts, with the first related to solid wastes and second one to hazardous wastes. For both of them the Government explicitly requires: the formulation of a catalogue with production techniques and equipments that can cause

severe environmental pollution and another one including all the mandatory recyclable solid wastes; the construction of facilities and sites for storing and treating industrial wastes; a declaration of the types, quantities, flow directions and storage treatment of the wastes. For the hazardous wastes the controls and requirements are more strict and severe than those for the solid ones.

As reported in text of all these laws the main purpose is of "preventing and controlling pollution and other public hazards, safeguarding human health and facilitating the development of socialist modernization". In order to pursue this goal, in addition to the requirements and orders included in the laws, the Chinese Government requests also to:

- incorporate into the national economic and social development plans the plans for environmental protection formulated by the State
- encourage the development of education in the science of environmental protection
- strengthen the study and development of the science and technology of environmental protection

- popularize scientific knowledge of environmental protection
- adopt measures suited to local conditions
- give awards to the entities and individuals that have achieved outstanding successes in the prevention and control of environmental pollution
- stress the active involvement and participation of the people's Government at all the levels but in particular the more crucial and empowered role of all the administrative competent departments.

VIOLATION AND LIABILITIES

Each Law states detailed list of violations.

Generally speaking the most common violations are related to any action that can cause environmental, water, soil or air damages, the refusal to apply proper system to prevent dangerous emissions and wasted materials, the refusal to report, the submission of false reports on items for which the declaration is required and the lack of immediate action to solve any eventual damage

Concerning the **liabilities**, at first it must be said that the laws establish four different kinds of

liabilities in addition to the order of stopping the illegal act:

- administrative liabilities (fines),
- penal liabilities,
- loss of business license or suspension of the production (for a defined period of time)
- order to make rectification.

Fines are the most common liability since they occur for almost any violations included in the laws, but at the same time they are quite variable depending on the gravity of the act. In fact the amount that has to be paid is not exactly defined for each case but instead are given some ranges. The average amount of the fines is between 10.000 Yuan and 100.000 Yuan. In specific cases when the gravity of the illegal act is high the fine can go up to 200.000 Yuan, for instance this is the case of a subject supplying or entrusting hazardous wastes to an entity that does not have a valid business licence. The worst scenario would be in case of serious environmental accident when the fine could reach its maximum amount either of 500.000 Yuan for atmospheric pollution accidents or 1.000.000 for pollution by solid wastes. It must be said that the laws are unclear about how the

gravity of the circumstances will be determined, leaving wide margin to the discretionary power of the authorities. Furthermore, for most of the violations is not explicitly requested the payment of the fine but it's said that the violator might be asked to pay an administrative liability.

When an entity violates the laws by missing the requirements referred to the compliance of facilities for prevention and control of pollution, discharging of pollutants in accordance to national and local standards, producing, selling, importing or using equipments that are prohibited and committing other similar gravity violations it might be asked to restore the situation, suspend its operations or in the most serious cases also to close down the activity with consequent loss of the business licence. When the violation is not too grave, the entity gets only ordered to make rectifications of the illegal behaviour within a defined deadline.

Lastly, the laws point out that if the illegal act constitutes a crime, the persons responsible for it will be subject to criminal liabilities, without mentioning the related details.

STATE ENVIRONMENTAL PROTECTION ADMINISTRATION (SEPA)

The department of environmental protection, officially known as State Environmental Protection Administration (SEPA) is a cabinet-level ministry in the executive branch of the Chinese Government. It's charged with the task of regulating water quality, ambient air quality, solid waste, soil, noise and radiation. Directly under the State Council it is empowered and required by law to implement environmental policies and enforce environmental laws and regulations. Under SEPA there are 12 offices and local departments and in 2006 it opened 5 regional centres to execute with local inspections and enforcement a closer and more accurate control. SEPA's organization is articulated in offices and departments spread all over the country in order to meet the environmental needs at State, province and city level.

Following there is a list of the main functions which are under SEPA's responsibility (S= at State level; L=at Local level):

- Supervision and management of environmental protection (S;L)

- Establish national and local standards for environmental quality (S;L)
- Issue bulletins on environmental situation (S)
- Investigate and asses the environmental situation (L)
- Receive and analyse the environmental impact assessment (EIA) related to new construction projects (S;L)
- Execute on-site inspections of units that discharge pollutants (L)
- Give approval to dismantle installations for the prevention and control of pollution (S;L)
- Warn or fine any violators of the law (L)
- Delimit specific areas at high rate of pollution (S)
- Publish catalogues of prohibited production techniques and equipments which seriously pollute the environment (S)

FDI PROJECT AND THE ENVIRONMENTAL IMPACT ASSESSMENT

One of the main functions of the Environmental Protection Department is to receive, publish and approve the Environmental Impact Assessment (EIA) related to any new project undertaken in China. The EIA requires the evaluation of

possible impacts that the project may have on the environment. The purpose of the assessment is to ensure that whoever decides to start a new project considers also the environmental impacts to decide whether to proceed or not.

The Environmental Impact Assessment Law (EIA Law) requires an environmental impact assessment to be completed prior to the project construction and it must be obtained in order to get the business license.

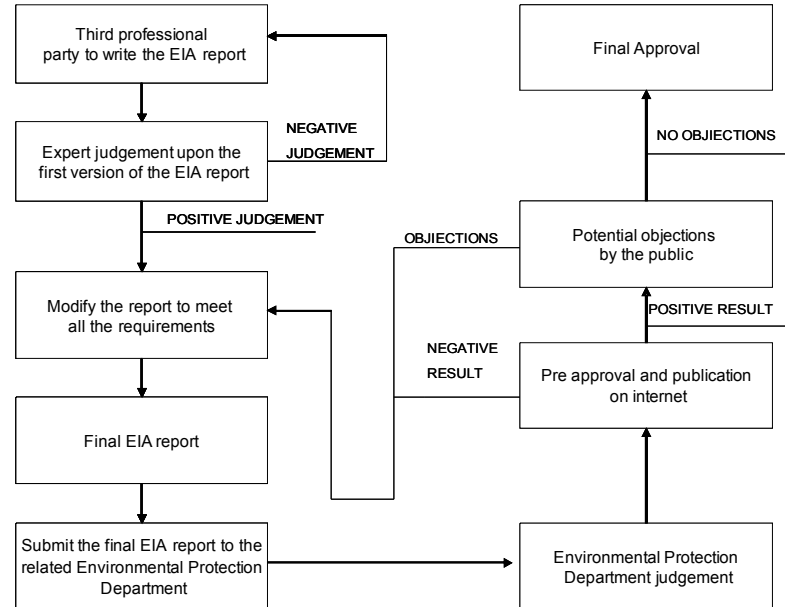
The EIA is required only for the production projects and not for service projects due to the low environmental impact produced by the latter.

For production projects there are two different procedures to be followed to get the EIA, depending on the nature on the project:

1. *Light waste – not dangerous project*
2. *Heavy waste – dangerous project (such as chemical)*

Light waste-not dangerous projects Investors need to prepare and submit to the related Environmental Department the EIA sheet in order to get the approval for starting the project. The EIA sheet requires a procedure that is simple and fast since basically consists of fulfilling some

standardized documents to ensure that all the requirements are met.



On the other side, the Investors in *heavy waste-dangerous projects* have to prepare and submit to the related Environmental Department the EIA report. The EIA report requires a much more complicated and longer procedure than the EIA sheet; in fact the whole procedure takes averagely more than three months.

Below it's showed a table illustrating the procedure that a company which wants to invest

in a new heavy waste-dangerous production project in China has to go through.

The first step of the procedure refers to the research of a professional third party which will be in charge of writing the EIA report; usually it is the EIA institute or a university.

After having the first draft of the EIA report written, this has to be examined by a pool of experts in the project industry belonging to local city or province's talent pool (depend on the importance of the project). The experts have the duty to analyse the EIA report and understand if it meets all the requirements and can be submitted to the Environmental Department for the final approval. In the case of negative judgement by the expert, the report must be rewritten again and so the procedure restarts from the beginning. Anyway, even if in case of positive result by the experts, in the following step the report might be modified in order to fully meet all the corrections/suggestions reported by the expert (usually this phase takes 1 or 2 weeks). Once the report has been approved, has fully met all the requirements and contains the EIA writer and Investor chop, the expert signature and all the required attachments (mainly investors and projects documents), it is submitted to the Environmental Protection Department for the final analysis. Depending on the importance, investment amount and geographic relevance of the project the report is submitted to the Environmental Protection

Department at either the State or province or city level. At this point, the related Environmental Department judges the report and if the result is positive, the report is published on the official web page on internet to give notice to anyone who might be interested in the impacts of the project. While, if the result is negative the report needs to be modified in accordance with the Environmental Department's corrections.

The pre approval of the report remains published on internet for 10 days in order to give the opportunity to the public to present any reasonable complaints about the project and the effects that it might causes. If there are no objections from the public the report is finally approved by the Environmental Department and the Investor can start the operations and the project construction.

GOVERNMENT APPROACH

As already said, the Chinese Government has decided to actively take step into the environmental issue in order to make it part of current and future basic state policies. It is actually putting more and more efforts in changing the pattern of economic growth. The

main goal is *"to take a new road to industrialization characterized by high scientific and technological content, good economic returns, low resource consumption, minimum of environmental pollution, and full use of human resources"* (Government White Paper on Energy, China's Energy Consumption and Policies). In terms of industry structure, the focus of this more environmental friendly policy will be on encouraging (i.e. trough higher tax benefits) the development of high tech technology and resource saving technologies and on upgrading traditional high resource consuming industries. Industries with high energy consumption, such as steel, non-ferrous metals, coal, electricity, petroleum and petrochemicals, chemical engineering and building materials, will be the target sectors for this upgrading. As reported on the Government White Paper on Energy, China's Energy Consumption and Policies, the Government *"will readjust the product mix, speed up technological reform, improve management and economize on energy. It will support a group of key and demonstration projects aiming to conserve energy and cut consumption so as to rally industries to enhance*

their energy-saving level. It will continue to raise the standards for energy efficiency of industry, eliminate backward and high energy-consuming products, and perfect the market access system”.

Over the last few years there have been critics on the application of the environmental protection laws mainly related to a lack of enforcement and consequent spread of illegal practices and behaviours. The current situation seems to be different. There are evidences that prove higher efforts from the State in enforcing the laws and in ensuring a more sustainable development of the country. As an example, in 2008 the Chinese Government closed some small power plants, with a total generating capacity of 8,360 MW, because they failed to meet requirements for clean production. Tighter controls have been done also to prevent the development of projects likely to have a high environmental impact. In the time period January - August 2008 a total of 439 projects were submitted for EIA approval. Of these, 104 projects, involving 314.56 billion Yuan (US\$46 billion) of investment, were either rejected or postponed.

Furthermore, pressures on enhancing the environmental policy don't come only from the gravity of the situation itself and from a higher awareness of the Chinese authorities, but also from abroad.

In fact all the international institutions are pushing China to this extent. Influences have been coming from the major United Nations bodies for environmental issues such as United Nations Environmental Programme (UNEP), Commission for Sustainable Development (CSD) and the Global Environmental Facilities (GEF) which have provided assistance in terms of policy formulation, technical assistance, public awareness and networking.

In the end, when considering the impact of the environmental protection regulations on FDI, higher attention over the environmental issue is put in analysing the aspects of any new project to be set up in China. It's important to deeply understand all the procedures, technical requirements, times and costs related to getting the approval from the relative authorities. To this extent, when planning and estimating the timing

for the project/activity set up, should be considered the long time that might be requested for handling the EIA report (if it's needed), in order to avoid mistakes in the scheduling process. Another important aspect of any investments that is affected by the environmental policy is the evaluation of the rate of return for the investors. To get a better understanding of the return from the investment, this valuation must include all the costs needed to incorporate the work of environmental protection such as the design and set up of the installations for the prevention and control of pollution.

To conclude, we can say that the environmental issue has become crucial in the investment process in China at the point that now it's considered one of the variables that might determine the success or failure of the investment and so it has to be carefully kept under consideration by any entity investing in China.

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For inquires and suggestions regarding this newsletter or for any other concerns; please contact us anytime at: info@jesa.com.cn

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NOTE

Due to server updating, we found some problems in delivering December Newsletter.

In case you have not received our previous Newsletter, please visit our website or contact us.

We apology for the inconvenience

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