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**Project advisory group:** Yang Chaofei, Wang Yi, Zhang Jiqiang, Rose Niu, Jin Jiaman

**Technical expert group:** Zhang Yansheng, Zhang Jianping, Jiang Heng, Zhang Mianli, Ge Chazhong, Long Feng

**Coordinators:** Ren Peng, Zhu Rong, Ji Lin

**Cartographer:** Kong Linghong, Peng Kui

# **Environmental and Social Challenges of China's Going Global**

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## **INTRODUCTION & ACKNOWLEDGEMENTS**

As worldwide economic integration picks up speed, the relationship between investment, trade and environmental protection has been an issue of mounting concern. China's Bringing-In and Going Global economic strategies have allowed China to become the world's largest emerging economy and has thrust China into the ongoing process of global economic integration. China now exerts a vital influence on the world's resource environment.

In 2010, the Chinese and English versions of *Environmental Policies on China's Investment Overseas*—written by the Global Environmental Institute (GEI) and its project partners—were published by China Environmental Science Press. It was the first work of its kind to examine and analyze the environmental risks and relevant policy recommendations concerning China's investment, assistance and credit overseas. The book was well received at home and abroad, but problems with dates of sourced data and data inadequacy were also identified. At the end of 2011—which marked the 10<sup>th</sup> anniversary of the launch of the Going Global Strategy, China's entry into the WTO, and the inaugural year of China's 12<sup>th</sup> Five-Year Plan—GEI's Trade Investment and Environmental project team contributed to the “China's Going Global Strategy and Corporate Environmental & Social Responsibility” section of *China Sustainable*

*Development Report 2012* prepared by the Chinese Academy of Sciences. Based on that work, GEI launched this research project in 2012 in order to review how the Going Global Strategy has been implemented over the past decade, to draw experience and lessons therein, to objectively analyze challenges facing the strategy, and to outline what might happen in the future. The ultimate goal of the report is to contribute to the sustainability (both financial and environmental) of the Going Global Strategy and Chinese overseas investment in general.

To ensure the quality of the report, we set up a project advisory group and technical expert group and held a series of seminars in the hope of engaging relevant governmental and non-governmental stakeholders in research on the environmental and social risks China faces in terms of foreign investment, international trade, and foreign aid, with a particular focus on China's Going Global Strategy. We reviewed the development process of China's Going Global Strategy, summed-up experience and lessons, and proposed alternative paths for future policy. GEI also participated in a variety of seminars at home and abroad which have also contributed to this report.

This research report was prepared by the technical expert group; revised, proofread and finalized by the project group. All the data in the report is based on publicly available information.

We are extremely thankful to World Wildlife Fund-US for its financial support for this project and the technical expert group for its professional and detail-oriented research work. We are deeply grateful to Mr. Yang Chaofei, Vice President of the Chinese Society of Environmental Sciences; Dr. Wang Yi, Deputy Director-General of Institute of Policy and

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## **EXECUTIVE SUMMARY**

Ever since the Going Global Strategy was articulated in China's 10<sup>th</sup> Five-Year Plan in 2001, China's overseas direct investment and international trade have been on the rise. During this period, China's outbound foreign direct investment has expanded to 178 countries and regions and skyrocketed from USD 6.9 billion in 2001 to USD 68.8 billion in 2010, ranking 1<sup>st</sup> among developing economies and 5<sup>th</sup> among all countries. China's international trade volume (imports and exports) has also soared from USD 509.8 billion to USD 2,974 billion during the same period, helping it become the world's largest exporter and 2<sup>nd</sup> largest importer in 2009 and 2010, respectively. Therefore, it would not be an overstatement to say that China has grown into a major force to be reckoned with in foreign direct investment and international trade. As China's 12<sup>th</sup> Five-Year Plan called for accelerating the pace of Going Global, how China will facilitate and regulate its overseas investment and international trade will have a significant impact on global sustainable development and governance.

This China Profile Report is intended to provide an overview of China's foreign direct investment over the last ten years since the introduction of the Going Global Strategy, including the history, status quo, and future trends of China's trade of major commodities over the next five years, as well as an analysis of China's foreign aid. This report will focus on the four regions that have received most of China's investment and the trade of 20 major commodities, in light of potential ecological impacts on these regions and high conservation value places identified by WWF.

This report also provides a review of the lessons learned from China's Going Global Strategy and the main strategic goals and policies outlined in the 12<sup>th</sup> Five-Year Plan. This includes a discussion of the integration of sustainability into the Going Global Strategy, especially in terms of the challenges arising from environmental protection and governance and sustainable use of natural resources. In addition, this report has examined the legal, policy, and regulatory frameworks for China's overseas

investment and trade, supplemented by case studies that may offer important guidance on sustainable development for other countries. Based on this analysis, the report has identified the gap in capacity building among major stakeholders and put forward actionable policy recommendations, with an aim to facilitate a positive impact from China's international economic activities. This report includes the following sections:

### **Chapter 1: Going Global Strategy in the Context of Globalization**

This section reviews the genesis and evolution of the Going Global Strategy against the backdrop of globalization, including an analysis of the main driving forces, stakeholders, and actors involved, and looks into the implications of the supporting policies and measures articulated in the 12<sup>th</sup> Five-Year Plan.

The world is now undergoing another wave of economic globalization that has given rise to the prospering of global trade and investment. Set against this broad context, China's Going Global is a conscious and strategic choice to open-up the Chinese market, participate in international division of labor and compete in the global market. The 'Opening-up and Reform' policy introduced in 1978 has initiated the practice of 'bringing-in' resources to nurture nascent markets and other economic drivers, and to partake in international economic exchange and competition, which has in a sense laid the technical and material groundwork for China's Going Global. The introduction of the Going Global Strategy through the 10<sup>th</sup> Five-Year Plan in 2001 coincided with China's ascension into the World Trade Organization in the same year. Underpinning these strategies lies the need to actively participate in economic globalization, to promote economic development through the 'bringing-in' of resources, the need for localization and 'going-out', and to take advantage of the 'two markets and two kinds of resources' (referring to domestic and international markets and resources).

The evolution of the Going Global Strategy has also reflected the changes in strategic focuses and direction. Initially, the Going Global Strategy stressed external processing trade and joint development of resources in short supply domestically and promoted diversification of suppliers and participation in overseas infrastructure development. Later on, the strategy transitioned to promoting building international sales networks and brands, as well as placing a strong emphasis on local communities' livelihood and implementation of corporate social responsibility.

Going Global—now increasingly geared towards 'common and green

development'—is set to become an integral part of China's economic restructuring. To follow these redefined concepts and principles of development, efforts should be made to:

- 1) Improve China's overseas investment management system,
- 2) Strengthen the capacity of government agencies to promote sustainable development,
- 3) Set up a support system for science-informed decision making and monitoring,
- 4) Streamline coordination between government agencies,
- 5) Increase the cooperation and exchange between China and the governments and civil societies of trading partners and their host countries.

## **Chapter 2: China's Overseas Investment, Trade and Aid**

This section examines China's overseas investment, international trade, and foreign aid individually. It builds a database of China's foreign direct investment in and trade of major commodities with countries in the four priority regions identified. This section also assesses how China's overseas investment and trade might impact the biodiversity and ecological services in these regions, as well as other associated social and environmental risks and challenges from China's perspective.

### **China's Overseas Investment**

This subsection provides an overview of China's overseas investment over the last ten years and a forecast for its future. Analysis focuses on how China's investment has had a social, economic, and environmental impact on the countries in the priority regions and also what challenges China has faced.

After over ten years as a member of the World Trade Organization, China's overseas investment has witnessed a growth rate far above the world's average. In 2010, China's overseas direct investment flow accounted for 5.2% of the world's total, ranking 5<sup>th</sup> globally. In contrast, China's outward direct investment flow and stock made up merely 0.50% and 0.39% of the world's total in 2002, ranking only 25<sup>th</sup> and 24<sup>th</sup>, respectively. In terms of investment flow, China's outward investment growth averaged 49.9% annually between 2002 and 2010, far exceeding most other economies in the world. Mergers and acquisitions alone accounted for 43.2% of China's investment flow, ranging from mining, manufacturing, power generation and supply, to

specialized service industries and the financial industry. Thanks to the world's economic slowdown China's outward direct investment in 2011 saw its first drop since 2003, down by 5% at USD 65.1 billion—ranking 9<sup>th</sup> behind USA, Japan, UK, France, HK, Belgium, Switzerland, and Russia.

On the one hand, China's economic interactions with these four priority regions have demonstrated strong complementary relationships. By the end of 2010, China had established nearly 2,000 directly invested companies in Africa, 2,300 in Southeast Asia (ASEAN countries), 800 in South America, and 800 in Russia. These investments contributed positively to local economic development by creating employment opportunities, improving local infrastructure, and upgrading local economic structure. On the other hand, these investments also gave rise to a host of other issues, such as impact on local enterprises, poor safety and sanitation standards, labor disputes, and environmental damages. Some medium and small-sized Chinese companies—conveniently neglected in many discussions—often have more social and environmental impacts disproportionate to their size.

### **China's International Trade**

This subsection provides an overview of the import and export of the 20 major commodities whose production and consumption have a great impact on the global environment. China, either as a producer and importer or as a processor and consumer, occupies an important place in the supply chain of these commodities. By looking deep into the trade data of these commodities, this subsection outlines China's needs for each commodity, including projected trends and analysis of the structure of the respective import and export markets. This subsection also juxtaposes the main export markets of selected major commodities with the WWF conservation priority places on maps. Doing this helps analyze the potential impacts of production and trade of these commodities on high-priority conservation areas, and helps to better pinpoint intervention points for restructuring the composition of Chinese industry and market transformation in the context of the global supply chain.

Though meant to be a starting point for exploring the green transformation of global markets, the analysis afforded by this subsection goes so far as to shed light on the varying degrees of concentration along the supply chain which suggests different leverage/intervention points for market transformation. For example, there is a high

concentration of supplying markets for soy, palm oil and beef, and as a result a high-leverage strategy would be to improve the environmental standards in commodity production in the source countries. By identifying China's position in the global supply chain for each commodity and the key producers, traders, processors, and end consumers involved, this analysis provides important reference for interested stakeholders to develop and refine strategies aimed at facilitating a green transformation of China's trade.

In mitigating the environmental impact from the production and consumption of these major commodities, there are additional considerations with important roles to play: international environmental conventions, environmental clauses in regional and bilateral trade agreements, environmental regulations in source countries, environmental standards, environmental guidance for foreign trade, voluntary sustainability standards, and industry innovations. Also noteworthy are efforts initiated by some international organizations to facilitate dialogue and cooperation on sustainability among actors along the supply chain. Source countries that rely on the production and processing of primary goods can contribute to the green transformation of the supply chain by strengthening their environmental legislation, governance and monitoring, and by implementing supportive policies that improve environmental protection, promote technical innovation, and foster industry upgrade.

### **China's Foreign Aid**

This section reviews the history of China's foreign aid practices, the existing foreign aid system and administration, and funding details. China's foreign aid can be traced back a long way, it was conceived and deployed as a strategic policy aimed at China's long term and overall national interests. China's foreign aid, bearing the stamp of the age, has revolved around China's foreign diplomacy, shaped by factors both domestic and international. 1978 served as a watershed year for China's foreign aid policy. Before 1978, China's foreign aid—echoing the greater theme of 'War and Revolution'—was very much ideologically informed. After 1978—in the context of the new global theme of 'Peace and Development'—China's foreign aid focused more on nurturing a peaceful international environment and good relations with neighboring countries, strengthening the bond with other developing countries, and facilitating the 'South-South' cooperation—all essential to China's national development.

In fact, China's foreign aid is characterized by the 'South-South' cooperation. As a member of the United Nations, China not only endeavors to meet the Millennium Development Goals (MDG) on its own, but also helps other developing nations achieve their MDG with the help of China's foreign aid. China has now expanded and diversified its foreign aid in the new millennium, and is increasingly using regional cooperation mechanisms and platforms to deliver foreign aid, shifting its previous focus from specific countries to regions. Overall, China has wedded its foreign aid policy to its Going Global strategy, transforming relations with other developing nations from 'aid provider vs. recipients' to across-the-board cooperation supplemented by aid.

China's foreign aid is also characterized by an emphasis on helping the countries it aids to develop their own capacity to develop, which will serve as an important policy vehicle for a long time. To respond to the emerging challenges in China's foreign aid, this subsection ultimately proposes the following recommendations: steadily increasing foreign aid; improving foreign aid research and developing long-term aid policies for both regional and country levels; optimizing the mix of foreign aid recipients; exploring innovative deliveries of foreign aid; improving policy framework for foreign aid; diversifying foreign aid to involve the private sector and civil society; and participating in and cooperating with the international aid community and platforms.

### **Chapter 3: Legal and Regulatory Requirements and Policy Framework**

This section catalogues the regulations and policies governing China's foreign direct investment and production and trade of commodities. These include the Environmental Protection Guidelines for Overseas Investment and Cooperation, co-released by the Ministry of Commerce and the Ministry of Environmental Protection, the Guide on Sustainable Overseas Silviculture by Chinese Enterprises (a voluntary measure released by the State Forestry Administration and the Ministry of Commerce) and the sustainable financing benchmark study for the Chinese banking sector initiated by WWF in cooperation with China Banking Regulatory Commission (which provided some preliminary assessment of Chinese banks' performance in environmental protection, sustainable use and management of natural resources, and green lending). This section also reviews international environmental standards and guidelines for

investment and trade, as well as sustainability tools (i.e. principles, standards, and certifications, etc.). More importantly, the section examines China's participation and involvement with regards to these international standards and assesses those standards' feasibility in China itself.

#### **Chapter 4: Case Studies**

Here we present an in-depth analysis of a few selected cases of China's overseas investment—both positive and negative—through which the environmental and social responsibilities as well as investment security are discussed and recommendations proposed.

As a latecomer to international investment, China can only access natural resources in places long considered politically contentious and conflict-ridden and ignored by Western countries and companies that have already monopolized safer and more easily accessible resources. This has proved particularly challenging for China's overseas investment when coping with social and environmental issues. Such social and environmental risks, if left unresolved, will be disruptive and even destructive for the long term viability of these investment projects and the safety of Chinese investors and personnel involved.

By examining the cases of Merowe Dam in Egypt, Myitsone Dam in Myanmar, Chambishi copper mines in Zambia, and illegal logging in Sierra Leone, this section identifies the following main social and environmental risks: 1) inadequate CSR awareness and poor monitoring; 2) insufficient communications with stakeholders and poor information disclosure; 3) unwise and indiscreet investment decisions that are set to intensify social conflicts; and 4) poor environmental standards and implementation in the respective host countries. Positive cases include the China Ocean Shipping Company and China Minmetals Corporation, which provide a rare but incisive glimpse of how some Chinese investors could succeed where their peer companies failed.

#### **Chapter 5: A Decade of Going Global—Past and Future**

While China's Going Global Strategy has gained remarkable economic results statistically speaking, it should also be noted that more and more Chinese companies have encountered various political, environmental and social risks when operating overseas. Some of these risks have led to companies' economic losses, while some



have even escalated to violent conflict. This section aims to summarize problems of the past decade by breaking-down and analyzing them at each point in the chain—the strategy itself, the Chinese government, Chinese enterprises operating overseas, and recipient countries. It then proposes policy recommendations for government officials, corporate managers, researchers and NGO practitioners, beginning with institutional optimization, corporate risk management, capacity building, and demonstration projects.