How China’s Policy Banks Can Support Sustainable Foreign Investment

HOW CHINA’S POLICY BANKS CAN SUPPORT SUSTAINABLE FOREIGN INVESTMENT

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# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abbreviations and Acronyms</td>
<td>1</td>
</tr>
<tr>
<td>Foreword</td>
<td>1</td>
</tr>
<tr>
<td>1. China’s policy banks and “going out” strategy</td>
<td>3</td>
</tr>
<tr>
<td>1.1 Policy banks and foreign investment</td>
<td>3</td>
</tr>
<tr>
<td>1.2 Policy banks and the environmental and social challenges of foreign investment</td>
<td>6</td>
</tr>
<tr>
<td>2. Bank policies for the prevention and control of environmental and social impacts and risks in investment activities</td>
<td>8</td>
</tr>
<tr>
<td>2.1 Environmental and Social Policies of the Export-Import Bank of China</td>
<td>9</td>
</tr>
<tr>
<td>2.2 The Environmental and Social Policies of the China Development Bank</td>
<td>14</td>
</tr>
<tr>
<td>2.3 The Environmental and Social Policies of the World Bank and the International Finance Corporation</td>
<td>17</td>
</tr>
<tr>
<td>2.4 The Environmental and Social Policies of the Japan Bank for International Cooperation</td>
<td>24</td>
</tr>
<tr>
<td>3. A comparison of environmental and social policies between China’s policy banks and international financial institutions</td>
<td>29</td>
</tr>
<tr>
<td>3.1 Weaknesses of the environmental and social policies of China’s policy banks</td>
<td>29</td>
</tr>
<tr>
<td>3.2 Progressiveness of the environmental and social policies of China’s policy banks</td>
<td>33</td>
</tr>
<tr>
<td>4. Case studies: Role of policy banks in the prevention and control of environmental and social risks</td>
<td>42</td>
</tr>
<tr>
<td>4.1 About Sri Lanka</td>
<td>42</td>
</tr>
<tr>
<td>4.2 Case 1: CMC and Southern Railway project (EPC mode)</td>
<td>45</td>
</tr>
<tr>
<td>4.3 Case 2: CHEC and The Colombo Port City project (PPP model)</td>
<td>49</td>
</tr>
<tr>
<td>5. Synthesized analysis and summary</td>
<td>52</td>
</tr>
<tr>
<td>6. Appendix: Key Definition and Introduction of Policy Banks</td>
<td>56</td>
</tr>
</tbody>
</table>
# ABBREVIATIONS AND ACRONYMS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADBC</td>
<td>Agricultural Development Bank of China</td>
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<td>BRI</td>
<td>Belt and Road Initiative</td>
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<td>CBRC</td>
<td>China Banking Regulatory Commission</td>
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<tr>
<td>CCER</td>
<td>Chinese Certified Emission Reduction</td>
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<tr>
<td>CDB</td>
<td>China Development Bank</td>
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<tr>
<td>CDM</td>
<td>Clean Development Mechanism</td>
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<tr>
<td>China EXIM Bank</td>
<td>The Export–Import Bank of China</td>
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<td>EHS</td>
<td>Environmental, Health and Safety Guidelines</td>
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<tr>
<td>EIA</td>
<td>Environmental Impact Assessment</td>
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<tr>
<td>ESF</td>
<td>Environmental and Social Framework</td>
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<tr>
<td>ESIA</td>
<td>Environmental and Social Impact Assessment</td>
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<tr>
<td>ESMS</td>
<td>Environmental and Social Management System</td>
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<tr>
<td>GEI</td>
<td>Global Environmental Institute</td>
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<tr>
<td>IDA</td>
<td>International Development Association</td>
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<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
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<tr>
<td>JBIC</td>
<td>Japan Bank for International Cooperation</td>
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<tr>
<td>M&amp;A</td>
<td>mergers and acquisitions</td>
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<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
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<tr>
<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
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<tr>
<td>WB</td>
<td>World Bank</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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</tbody>
</table>
Since the “going out” strategy was launched, China’s foreign investment has enjoyed rapid growth. In 2015, China’s foreign direct investment hit USD 145.67 billion, a 54-fold increase over that of 2002. During the “going out” process, Chinese enterprises, by expanding overseas markets and deepening technology exchanges, have not only improved their international competitive edge but also injected new economic dynamics into the host countries. Encouraged by the smooth development of the “going out” strategy, the Chinese government proposed the Belt and Road Initiative (BRI), setting cross-border economic belts as the primary strategy for foreign economic development. The initiative plans to advance the infrastructure construction in West China and countries along the “Silk Road Economic Belt” and the “21st Century Maritime Silk Road”, in an effort to promote regional connectivity and economic development.

Although the overall implementation of “going out” strategy has achieved major outcomes, the environmental and social risks and impacts of some investment projects have become increasingly prominent, causing disputes in the host country and the international community and posing obstacles to the development of these projects. The BRI has opened a new window of opportunity for China’s foreign investment. While China’s overseas investment will have stronger influence on economy, environment, and society, it also faces more environmental and social risks. How to effectively prevent and control these risks and the negative impacts is key to the sustainability of overseas investment projects.

The Global Environmental Institute (GEI), as a Chinese non-governmental and non-profit organization specialized in environmental issues, has been committed to addressing sustainable overseas investment issues since its inception. Based on our field visit and research, GEI has proposed the Chinese government to launch environmental policies on overseas investments and build host country’s capacity in environmental governance, and provided environmental and social advice for overseas investment enterprises. In the past decade, GEI has initiated and participated in the compilation of a number of policy papers, including *A Guide on Sustainable Overseas Silviculture by Chinese Enterprises* and *Guidelines for Environmental Protection in Foreign Investment and Cooperation*, and paid close attention to the development and implementation of China’s foreign investment environmental policies.

Through long-term observation and research, we found that banks, as essential creditor and investor of overseas development projects, have the mandate to regulate and guide enterprises’ environmental and social behaviours by formulating and implementing related policies, and reducing credit and investment risks caused by environmental and social problems.
In 2012, China Banking Regulatory Commission (CBRC) launched the Green Credit Guidelines, stipulating that banks should effectively identify and control the environmental and social risks in credit business, improve relevant credit policies and workflow management, and ensure that credit will be granted to those who will comply with environmental protection, health, and other relevant laws and regulations of the host country, and follow relevant international practices or standards. In August 2016, the People’s Bank of China, along with the Ministry of Finance and five other ministries, issued the Guidelines for Establishing the Green Financial System, suggesting banking and financial institutions develop green credit and strengthen environmental risk management of the projects under the BRI and other investment frameworks and promote green foreign investment.

As China’s policy banks, the Export-Import Bank of China and the China Development Bank are important financial supporters of the “going out” strategy and BRI. They are also the pioneers in green finance. The environmental and social policies adopted by these two banks not only have substantial influence on the environmental and social standards of overseas projects, but also play an exemplary role for other banks in China in developing related standards.

Through literature analysis and interview, on basis of examining the current environmental and social policies on overseas projects adopted by the Export-Import Bank of China and the China Development Bank, and by comparing these policies with the measures taken by the World Bank, the International Finance Corporation, and the Japan Bank for International Cooperation, this report explores China’s policy banks’ responsibility and role in promoting enterprises’ overseas investments and green investments, and provides suggestions for them on optimizing environmental and social policies for sustainable overseas investments. It is hoped that this report will be useful for those interested in this topic.
1. CHINA’S POLICY BANKS AND “GOING OUT” STRATEGY

1.1 POLICY BANKS AND FOREIGN INVESTMENT

In the context of deepening economic marketization and globalization, China proposed the “going out” strategy and joined the World Trade Organization or WTO in 2001. Since then, China has not only opened its door to foreign capital and advanced technology but also encouraged its own enterprises to go abroad to make full use of the opportunities brought by globalization by making overseas investments, carrying out economic cooperation and developing cross-border businesses.

China’s overseas investments go hand in hand with its “going out” strategy. Driven by dual incentives of market needs and policy encouragement, China’s overseas investments have enjoyed a rapid increase. In 2015, China’s foreign direct investment flows hit a record high of USD 145.67 billion, accounting for 9.9% of the world’s total, the second highest in the world. As of the end of 2015, a total of 20,200 domestic investors had opened 30,800 direct foreign investment enterprises in 188 countries (regions) across the globe, covering all sectors of the national economy with the total assets of USD 4.37 trillion. These investments have not only brought China’s money, technology, products and equipment to the rest of the world but also enabled the Chinese enterprises to further integrate into the economic globalization through mergers and acquisitions (M&A) and green field investments.

Figure 1-1: China’s Foreign Direct Investment 2002-2015 (Unit: billion USD)

Source: 2015 Statistical Bulletin of China’s Outward Foreign Direct Investment
In the process of “going out”, Chinese enterprises received essential support from policy banks which provide them with capital and policy guidance. In 1994, as a result of the financial system reform, China established three policy banks, namely, the Export-Import Bank of China (China Exim Bank), the China Development Bank (CDB), and the Agricultural Development Bank of China (ADBC). After the “going out” strategy was launched, China Exim Bank was the first to receive the directive from the government to provide financial support for “going out” enterprises. In 2004, the National Development and Reform Commission (NDRC) and China Exim Bank jointly issued the Notice on Giving Credit Support to the Key Overseas Investment Projects Encouraged by the State, which stipulated that China Exim Bank should arrange a certain scale of credit funds in each year’s export credit plan to support key overseas investment projects encouraged by the State. Shortly afterwards, thanks to its outstanding performance in financing medium- and long-term development projects, CDB was assumed the responsibility to support enterprises in international cooperation. In 2005, NDRC and CDB jointly issued the Notice about Relevant Issues on Providing More Financial Support to Key Overseas Investment Projects, which provided that CDB should arrange a special amount of loan fund in its annual equity loans to support key overseas investment projects encouraged by the state.¹

As of the end of 2010, China Exim Bank had supported more than 1,300 “going out” projects, covering more than 100 countries and regions with the total contract amount exceeding USD 190 billion.² “Going out” enterprises can apply for export buyer’s credit, loans for overseas project contracting and overseas investment, and other credit financial products from China Exim Bank. In 2015, the bank supported the export of mechanical and electronic equipment, high-tech products, overseas contracting projects and investment worth USD 391.2 billion. The 2015 year-end balances of overseas investment loans and international cooperation loans were USD 30.5 billion and USD 84.5 billion respectively and 84% of the year-end balances of international cooperation loans went to overseas contracting projects.³ Aside from supporting enterprises to go abroad with the bank’s ordinary services, China Exim Bank also provides preferential loans for enterprises in their overseas business. The two preferential facilities are the Chinese Government Concessional Loan⁴ and Preferential Export Buyer’s Credit.⁵ Both facilities mainly assist borrowing countries in infrastructure

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³ Data from the Export-Import Bank of China Annual Report 2015. The USD-CNY exchange rate was 6.764.
⁴ Chinese Government Concessional Loan includes medium- and long-term low-interest loan in Chinese yuan. Loan funds are raised by China Exim Bank itself, and the government helps subsidize the interest margins. The Loan is operated by the Department of Foreign Assistance under the Ministry of Commerce and the Administration & Law Enforcement Department under the Ministry of Finance.
⁵ Preferential Export Buyer's Credit aims to promote the economic and trade cooperation between China and key countries and regions. It is provided to foreign entities in the form of export buyer’s credit with certain preferential terms, and is funded by China
construction projects, production projects, energy resource projects, and social welfare projects such as construction of hospitals and schools. Moreover, China Exim Bank is also the major sponsor of several funds, including China-ASEAN Investment Cooperation Fund and China-Central and Eastern Europe Investment Cooperation Fund, which facilitate, in various forms such as equity investment and quasi equity investment, the projects in areas of infrastructure, energy, and natural resources in the ASEAN and Central and Eastern Europe regions.

Whereas CDB is not equipped with the policy function for providing the Chinese Government Concessional Loan and Preferential Export Buyer’s Credit, it has moved faster and further than China Exim Bank in supporting enterprises to build overseas economic cooperation through vigorously expanding development financial services. The balance of CDB’s foreign exchange loans increased from USD 16.2 billion to USD 267 billion from 2005 to 2015, a 15-fold rise, and for many years since 2009 CDB has maintained the highest balance of foreign exchange loans among all Chinese banks. It mainly supports overseas projects in the areas of energy, mining, infrastructure, equipment manufacturing and agricultural processing. Apart from its credit businesses, CDB also provides overseas projects with common equity investment products and structured mezzanine investment products via multiple platforms such as its subsidiary CDB Capital, China-Africa Development Fund, China and Portuguese-speaking Countries Co-operation and Development Fund, and Pakistan-China Joint Investment Company, in an effort to promote both bilateral and multilateral economic cooperation between China and other countries, including African and Portuguese-speaking countries.

In 2013, the Chinese government proposed the BRI to strengthen the construction of transport, energy, and communications infrastructure in the countries along the “Belt and Road”, so as to realize connectivity and facilitate regional trade and investment. The BRI showed enterprises a more detailed roadmap to go out and ushered in new opportunities for overseas project contracting and investment. As China’s policy banks, China Exim Bank and CDB have actively responded to and supported the Initiative. At the end of 2014, a 40-billion-dollar Silk Road Fund was co-established by China Exim Bank, CDB, State Administration of Foreign Exchange (SAFE) and China Investment Corporation to finance economic and trade cooperation as well as multilateral and bilateral connectivity within the BRI framework. As of the end of 2015, China Exim Bank had more than 1000 outstanding loan projects in various fields including highway, railway, electricity and communication, with a total outstanding loans of more than RMB 520 billion, accounting for 37% of the banks’ overseas loans. By July 2016, CDB had issued loans totaling USD 162.1 billion to countries along the “Belt and Road”, with a balance of USD 112.2 billion, accounting for 35% of CDB’s overall

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6 China Exim Bank’s BRI loans rose by 50% last year, accounting for 37% of its total overseas loans. Reuters. http://cn.reuters.com/article/eibc-loans-idCNKCS0USZ20160114
international businesses. As the BRI has been gradually put into practice, both policy banks will keep expanding financial support for overseas investment projects and facilitating regional financial integration.

The credit financial services provided by China Exim Bank and CDB have played an important role in supporting and advancing the “going out” of enterprises, particularly the overseas mega-projects in the areas of energy, mining, infrastructure and equipment manufacturing. Meanwhile both banks have kept improving and expanding their overseas businesses and have gradually opened more overseas offices. As of the end of 2015, China Exim Bank had established Paris Branch, Representative Office for Southern and Eastern Africa (Johannesburg), St. Petersburg Representative Office and Representative Office for Northern and Western Africa (Morocco). Its banking network covers over 160 countries and regions worldwide. In 2005, CDB dispatched its first overseas working group. In 10 years’ time, CDB has grown into China’s biggest overseas investment cooperation bank and development financial institution with the largest size of global assets. It has opened one offshore branch in Hong Kong, six representative offices and more than 50 working groups in Cairo, Caracas, London, Moscow, Rio de Janeiro and Vientiane. Its international businesses cover 115 countries and regions.

1.2 POLICY BANKS AND THE ENVIRONMENTAL AND SOCIAL CHALLENGES OF FOREIGN INVESTMENT

The “going out” strategy has been well implemented and China’s direct foreign investment has grown consistently, nevertheless the way to go out has been rather bumpy. According to the 2014 annual accounting statement on overseas investment enterprises, 22.8% of the overseas enterprises were running in the red in their investment businesses while the rest 77.2% were in the black or breaking even. The loss rate of the 2,000 state-owned enterprises’ overseas businesses was even higher, standing at 25.6%. Since 2014, the completion rate of Chinese enterprises’ cross-border M&A is only 67%, far lower than the rate of buyers from developed markets.9

There are various reasons for failed foreign investment, and environmental and social risks are two important factors among them. In Southeast Asia, the Mistsone Dam project, Chaey Areng Hydropower project and Letpadaung Copper Mine project were called off due to environmental concerns and resettlement-related issues. In Africa, Chinese mining corporations were frequently embroiled in labour conflicts which sometimes escalated into strikes or violent riots. In Latin

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America, the Dragon Mart project in Cancun Mexico was cancelled due to environmental concerns. Driven by the BRI, overseas investment will influence the economy, the environment, and the society more profoundly, and the environmental and social risks will become more prominent, particularly in countries and regions where environmental governance and social security systems are weak. How to effectively prevent and control these risks and negative impacts is critical to the sustainability of overseas investment.

The exacerbation of environmental and social problems caused by overseas investment projects has started to draw the attention of relevant Chinese government departments, international environmental and labour organizations, and local media and civil society organizations in the host countries on the environmental and social responsibilities financial institutions should take in supporting overseas investment projects. China Banking Regulatory Commission (CBRC) launched the *Green Credit Guidelines* in 2012, stipulating that banking institutions shall effectively identify, measure, monitor and control the environmental and social risks associated with their credit activities, establish environmental and social risk management system, and improve relevant credit policies and workflow management. The *Guidelines* also provides that banking institutions shall ensure the owner of the overseas projects abide by applicable laws and regulations on environment, land, health, safety of the host country, adopt related international practices or international norms and follow good international practices. It also requires that banking institutions make their green credit strategies and policies public, release relevant credit information about the projects with major potential environmental and social risks, and accept monitoring by the market and stakeholders. In August 2016, the People’s Bank of China, along with the Ministry of Finance and other five governmental agencies, issued the *Guidelines for Establishing the Green Financial System*. This *Guidelines* suggests financial institutions to develop green credit, strengthen environmental risk management of BRI and other overseas investment projects, and promote green overseas investment.

China Exim Bank and CDB are major financial supporters for the “going out” strategy and the BRI. Their environmental and social policies not only play an important role in restricting and guiding the environmental and social behaviours of the overseas projects, but also affect relevant standards and practices in China’s banking sector. Policy banks can reduce credit and investment risks caused by environmental and social problems, and assist overseas investment enterprises to better deal with environmental and social challenges by strengthening the formulation and implementation of environmental and social policies and standards.
The international financial community has agreed that financial institutions have the responsibility to review, assess, prevent and control the environmental and social impacts and risks arising from investment and financing activities supported by them. This understanding started to take form in the 1860s when the environmental issues entered the eyes of the public. In 1969, the World Bank (WB) appointed the first environmental advisor. In 1970, WB established the Office of Environmental Affairs. In June 1972, the United Nations Conference on the Human Environment was held in Sweden’s capital Stockholm where more than 1,300 representatives from 113 countries and international institutions convened for the meeting. Environmental issues were officially included in global governance agenda.

The World Bank and the International Finance Corporation (IFC) are global pioneers and leaders in developing environmental and social policies and standards for financial institutions. In 1987, for the first time, WB laid out requirements on environmental assessment for the projects it supported and gradually developed a series of policies for environmental and social protection and risk prevention and control since then. The policies cover natural habitats, pest management, forests, safety of dam, involuntary resettlement and indigenous peoples. In 1997, WB integrated its core environmental and social policies into the framework of the Safeguard Policies, requiring all supported projects to comply with the provisions of the Safeguard Policies while abiding by the laws and regulations of their host countries. This requirement ensures that investment and development projects will live up to high environmental and social standards even if their host countries have unsound policies on environmental governance and social safeguard.

Compared with WB’s Safeguard Policies, the *Performance Standards on Environmental and Social Sustainability* launched by IFC in 2006 has exerted a much more profound influence upon international financial institutions. The *Performance Standards* provided specific environmental and social requirements for IFC clients, covering eight areas including assessment and management of environmental and social risks and impacts, labour and working conditions, resource efficiency and pollution prevention, community health, safety and security, land acquisition and involuntary resettlement, biodiversity conservation and sustainable management of biological natural resources, indigenous peoples, and cultural heritage. Not only do IFC-supported investment projects need to comply with the provisions of the Performance Standards, but those financial intermediaries in collaboration with IFC also need to establish an environmental and social assessment and management system in accordance with *Performance Standard 1: Assessment and Management of Environmental and Social Risks and Impacts*. By the end of 2016, 85 financial institutions from 35
countries have adopted the Equator Principles, a framework based on IFC’s *Performance Standards on Environmental and Social Sustainability*, to assess and manage environmental and social impacts and risks in project financing.

The implementation of either the WB’s *Safeguard Policies* or IFC’s *Performance Standards* should meet the requirement of information disclosure. Both policies have been under constant reviews and revisions since their businesses and clients are ever-changing and people’s understanding about the value and vulnerability of global public resources keeps improving.

While China’s policy banks have far less experience in doing overseas businesses than the WB and the IFC, expectations from environmental and development agencies, western media and communities in investment recipient countries are not lower for China’s policy banks’ environmental and social performances than the best practices required by the WB. By closely examining the environmental and social policies developed by China Exim Bank and the CDB, this report has found that government regulations such as the *Green Credit Guidelines* issued in 2012 by the China Banking Regulatory Commission, have played an overarching role in the policy-making process. The two banks have integrated the management of environmental and social risks and impacts arising from their supported projects into the whole credit process of pre-loan investigation, loan review and approval, and post-loan management. Similar to the WB and the IFC, China Exim Bank and CDB have classified and graded the projects’ environmental and social risks and required that overseas projects should meet the environmental and social requirements set up by the government of the host country.

It shows that China’s policy banks have made rapid progress in environmental and social policies over the past decade. However, China’s policy banks are still in the early stage in disclosing environmental and social information, and consulting with multi-stakeholders in policy deliberation and formulation. This chapter, therefore, will analyze the environmental and social policies of the China Exim Bank, the CDB, the WB and the IFC to gain deeper insight into the development history and basic knowledge of the policies laid down by China’s policy banks and international multilateral development institutions. Similar discussions will also be conducted on the Japan Bank for International Cooperation (JBIC), whose functions and goals are similar to those of the China’s policy banks, in an effort to provide comparative reference for the Chinese counterparts.

### 2.1 Environmental and Social Policies of the Export-Import Bank of China

Established on July 1, 1994 and headquartered in Beijing, the China Exim Bank is a policy bank fully funded by China’s Ministry of Finance, under the direct leadership of the State Council. The credit ratings of the China Exim Bank are compatible with China’s sovereign credit ratings. Its operational capitals are raised from the People’s Bank of China in the form of re-lending, as well as from bond issuance both at home and abroad. Through financial services, the China Exim Bank has committed to expanding the import and export of mechanical and electronic products, packaged equipment and high-tech products, promoting competitive corporations to make overseas contract project and
investment, and advancing the development of China’s foreign relations and international economic and trade cooperation.

In 2015, different types of loans provided by the China Exim Bank totaled RMB 1077.4 billion. The major types are foreign trade loans, overseas investment loans, international cooperation loans, loans for supporting greater openness, government concessional loan and on-lending loans from foreign governments and international financial institutions. Among them, foreign trade loans, overseas investment loans, international cooperation loans and government concessional loan are mainly offered as credit support for international economic cooperation.

**Environmental and Social Policies**

The China Exim Bank began to develop environmental and social policies in 2007 when it set up the green credit strategy to “encourage green credit business development and actively control environmental and social risks in credit granting” and launched the Guidelines of Environmental and Social Assessment of Lending Projects. In accordance with the Guidelines, the China Exim Bank controls environmental and social impacts by conducting pre-loan investigation, in-loan review and approval, and post-loan management and supervision.

As for domestic projects, the China Exim Bank, in the light of national policies of energy conservation, emission reduction and industrial restructuring, has reduced its credit support for projects characterized by high pollution, high energy consumption, excessive capacity and outdated capacity. In contrast, more support has been dedicated to clean production, recycling economy, environmental protection, and technological transformation for energy conservation and emission reduction. In cases of violation of environment laws or excessive energy consumption, new loan won’t be granted to the borrower and the existing loan will be gradually withdrawn. Apart from reviewing the environmental and energy consumption records, the bank will also assess the environmental impacts of construction projects in line with comments from environmental protection authorities. Any project that failed to pass the environmental approval will not be able to get loans.

As for the environmental and social impacts of overseas projects, the Guidelines set environment policies and standards of the host country as the benchmark for assessment. When submitting loan application, the borrower or the project owner should also submit approval documents issued by the authorities of the host country, together with an assessment report on the environmental and social impacts of the project. China Exim Bank will grant loans to any project that has failed to get approval from the host country. The Guidelines also pointed out that if related policies or standards are not in place in the host country to assess the environmental and social impacts, the project should refer to Chinese standards or international practices; the project should respect local residents’ rights to land

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and resources and properly handle immigration issues; any negative impacts caused by the project should hold public consultation at the request of the host country.

In post-loan management and supervision, the China Exim Bank will examine and supervise the construction and operation of the project, in accordance with the assessment results of the environmental and social impacts of the project. If grave environmental and social problems emerge in the construction and operation of the project, the bank will require the project to take remedial or preventive measures, or the bank will terminate the loan.

In 2015, the China Exim Bank replaced Guidelines of Environmental and Social Assessment of Lending Projects with Green Credit Guidelines. As the newest policy to promote green credit, the Green Credit Guidelines laid out more comprehensive and specific requirements for a green, low-carbon and recycling economy and a stronger environmental and social risk management. It covers a range of aspects including organizational management, policy system, workflow management, internal control management, and information disclosure. Compared with the previous Guidelines, the Green Credit Guidelines has made new regulations in the following aspects:

- Specified capacities of each department in the formulation and implementation of the green credit strategy.

- Classified clients into A, B and C three different types in view of the degree of the potential environmental and social impacts and risks arising from their construction, production and operation. The dynamic classification management will help the bank give clients ratings, grant loans, review and approve loans and improve post-loan management.

- Integrated work related to environmental and social risks into due diligence of credit granting, e.g. land acquisition and involuntary resettlement, biodiversity conservation and sustainable management of biological natural resources. Client rating and credit granting department at all levels should issue written reviews on environmental and social risks of the clients.

- Included environmental and social responsibilities into loan contracts for both domestic and overseas projects. Loan application requires domestic projects to submit pre-approval or approval of land use, documents on safe production and hygienic/health standards, as well as environmental impact assessment (EIA) from the environmental authorities.

- Required fixed assets projects classified as Type A to establish complaint response mechanisms, channels conducive to communicating with stakeholders, and emergency plans to deal with major environmental and social risks.

- Required post-loan report to include information on environmental and social impacts, and highlight the assessment of environmental and social impacts of Type A and B projects in the report. In case of emergent environmental and social events, the borrower or the project owner should take measures to eliminate the impacts.

- Established an internal reporting and accountability system, taking into consideration the environmental and social risk management when non-performing loans and bad debts take place.
- Opened green credit express service to prioritize clients in green, low-carbon and recycling economy for credit granting.

Apart from the *Green Credit Guidelines*, the China Exim Bank also developed tailored credit-granting guidance for several industries. With these differential credit policies, the bank helps lead enterprises with high energy-consumption and high pollution to conserve energy, reduce emission and realize industrial transformation and upgrading. The bank also establishes green credit identification and statistical system, so as to improve the management of green credit businesses.\(^\text{11}\)

Table 2-1 listed China Exim Bank’s key environmental management sections of loan projects.

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<th>Loan Life-cycle</th>
<th>Requirements for environmental and social risk management and control</th>
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<tr>
<td>Pre-loan investigation</td>
<td>Collect information on environmental and social risks of clients’ or project’s energy consumption and environmental compliance. Initially classify clients according to its environmental and social risk type.</td>
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<tr>
<td>Loan review and approval</td>
<td>Conduct a thorough investigation into the environmental and social risks of the client or project. Departments responsible for credit rating, granting and examination should present written reviews on the environmental and social risks faced by the client in the review and approval report (including pre-review). Opinions on the client’s potential environmental and social risks, measures to be taken by the client for the management of the environmental and social risks (if applicable), and classification of the client’s environmental and social risks should be included. Projects that failed to get the approval and environmental documents by the host country should not be granted credit. Clients in support of a green, low-carbon and circular economy should be given the priority in terms of credit review and approval.</td>
</tr>
<tr>
<td>Contract management</td>
<td>Include environmental and social responsibilities in loan contract to monitor and constrain the borrower’s behaviours. Require projects classified Type A to establish complaint response mechanisms, channels conducive to communicating with stakeholders, and emergency plans to deal with major environmental and social risks.</td>
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<tr>
<td>Loan granting</td>
<td>Suspend or terminate the loan if severe potential risks were found during loan granting and payment review process.</td>
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\(^{11}\) Ditto
How China’s Policy Banks Can Support Sustainable Foreign Investment

| Post-loan Management | Include information on the environmental and social impacts in post-loan examination report. For projects under construction, examine mainly the actual environmental and social impacts of the projects, and monitor the implementation of measures to control and eliminate the. For completed projects, the examination should focus on whether the borrower or the project owner has obtained the environmental protection acceptance documents upon completion of the project. Keep track of the environmental and social risk updates of the operating projects. |

Supporting Measures for Green Investment

The China Exim Bank’s support for green investment is mainly demonstrated in its green credit strategies. On the one hand, it enhanced support for green, low-carbon and recycling economy by establishing express services for the review and approval of green credit. On the other hand, it is able to identify and manage the environmental and social risks in credit granting by establishing an environmental and social risk management system. In 2015, domestic and overseas projects supported by the China Exim Bank managed to reduce a total consumption of 5.0572 million tons of standard coal, emission of 14.0199 million tons of carbon dioxide, 24.1 thousand tons of sulfur dioxide and 4,790.29 tons of nitrogen oxides. 12

Apart from green credit, the bank has also launched multiple equity investment funds, such as the Japan-China Energy and Environment Conservation Fund, to promote the development of energy conservation and environmental protection industries at home and abroad in the form of financial cooperation. For example, more than 55% of the China-CEE Fund’s investment goes to clean energy field such as wind power generation and photovoltaic power generation. These projects have helped reduce CO2 emission by nearly two million tons in Poland and the Czech Republic. Also, the Mombasa-Nairobi Railway project supported by the China Exim Bank, in line with the animal routes provided by the Kenya Wilderness Service, has set up 14 special pathways, 600 culverts and 61 bridges for animals to pass. The construction has been flexibly adjusted to suit animals’ sleeping time and living habits. 13

Meanwhile, following closely the development of the emission trading market, the China Exim Bank launched carbon finance services with the focus on carbon asset consultation. The financial intelligence services helped enterprises to develop Clean Development Mechanism (CDM) in the international market, manage carbon assets and develop Chinese Certified Emission Reduction (CCER) projects in the domestic market. 14

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2.2 THE ENVIRONMENTAL AND SOCIAL POLICIES OF THE CHINA DEVELOPMENT BANK

The China Development Bank (CDB) was founded in 1994 as a development and policy-based financial institution, under the direct leadership of China’s State Council. It provides medium- and long-term financing facilities to serve China’s major medium- and long-term national economic development strategies. Domestically, the CDB supports key development areas such as infrastructure, basic industries, pillar industries, strategic emerging industries and major national projects. It also supports the rebuilding of shantytowns and development-oriented poverty reduction projects to improve people’s livelihoods. Internationally, it endeavors to help Chinese corporations to “go out” and supports the BRI strategy.

By the end of 2015, CDB’s total assets amounted to RMB 12.3 trillion, making it the largest Chinese bank for foreign investment and financing cooperation, long-term lending and bond issuance, and the world’s largest development finance institution. At present, CDB has 40 domestic branches, six overseas representative offices, and four subsidiaries including the China Development Bank Capital, the China Development Bank Securities, the China Development Bank Leasing and the China-Africa Development Fund.

Environmental and Social Policies

The CDB is one of the first banks in China to have established environmental and social policies. As early as in 2005, it required all lending projects to carry out Environmental Impact Assessment (EIA) in accordance with the law. In 2006, CDB became the first Chinese financial institution to join the United Nations Global Compact and pledge to abide by UNCG’s 10 principles in human rights, labour standards, environment, and anti-corruption. In the same year, the bank joined the United Nations Environment Programme – Finance Initiative and started to try sustainable finance practices.

Since 2007, CDB has rolled out the annual Working Plan of CDB for Loans to Reduce Pollution and Emissions. By adjusting the loan structure, it aims to reduce lending to industries with high energy consumption, high pollution and outdated capacity, and increase financial support to major energy-saving, emission reduction and pollution prevention and governance projects. In 2014, the CDB further improved its environmental and social policies by developing the Green Credit Work Plan and the Interim Measures for Green Credit Management and integrated the assessment of environmental and social risks into the whole lending process from project development, review and approval for credit granting, and post-lending management:

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- During the project preparation period, pay high attention to the solutions in the construction plan of pollution control, health, immigration and other issues, and require the project to meet the applicable standards and requirements on environmental protection, emission reduction, safe production and occupational safety and health;

- During the project review and approval period, set up a special credit rating indicator for “environmental behaviours”, integrate the management of environmental and social risks into the process of credit rating and the review for credit granting. For industries that are likely to cause severe environmental and social impacts, make “a list of environmental and social risks of major clients in the industries” and review the project risks in accordance with the list;

- During the post-loan management period, build a feedback mechanism for the tracking and prediction of credit risks, to monitor the environmental risks of the project and conduct active prevention and a priori dynamic risk alarming management. In case of environmental rules and regulation violations or major safety accidents, downgrade the company’s asset quality rating. Loans will be limited or terminated for severe violations.

In 2015, the CDB launched Circular on work on green credit management on domestic RMB loan project, Proposal on work concerning green credit 2015, and on contents of implementing green credit in Foreign Exchange Loan Contract and the supplementary contract and Framework document on environmental and social risks management of foreign exchange loans. The three documents made further requirements for the implementation of green credit policies and the management of environmental and social risks for international cooperation projects: both domestic RMB loan projects and international cooperative foreign exchange loan projects should follow the same green credit principles to evaluate the environmental and social risks. It evaluates all-round risks through the whole credit process from loan contract signing, loan payment, to post-loan management with differentiated approach.

**Supporting Measures for Green Investment**

The CDB promotes green investment mainly by providing credit support for projects in the green, low-carbon and recycling economic sectors such as pollution control, renewable energy, energy conservation and environmental protection, and modern agriculture. From 2011 to 2015, the CDB has issued loans worth RMB 300 billion to the renewable energy industry and supported more than 1,000 domestic new energy projects. In 2013, the CDB formulated the Corporate Social Responsibility Special Planning, which laid out sustainable development model, included environmental protection into strategically important areas, and committed itself to financing for sustainable economic, social and environmental development. In 2015, the CDB issued loans of RMB

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19 China Development Bank 2015 Sustainability Report

20 Ditto.
191.9 billion to energy conservation and environmental protection, and by the end of 2015, the balance of the green loans stood at RMB 1.57 trillion.  

The CDB has taken the “plan in advance” approach to actively engage with the government in drawing up economic and social development plans and providing corresponding supportive systematic financing for national green development strategies. In 2015, for example, the CDB and the Ministry of Industry and Information Technology (MIIT) jointly issued Notice on Recommending Key Projects for Industrial Energy Conservation and Green Development in 2015-2016. The notice singled out the following key areas for main financial support: technological renovation for industrial energy and water conservation, digital energy efficiency improvement, clean production transformation for key industries and corporations, comprehensive utilization of solid wastes and renewable energy resources, energy conservation and environmental protection industries. MIIT formed the Catalogue of Recommended Key Projects for Industrial Energy Conservation and Green Development, based on the recommendations from all provinces, autonomous regions and municipalities directly under the central government. The CDB took the helm of credit review and approval to provide financing and other comprehensive financial services for the projects in the catalogue.

Moreover, the CDB has also actively developed new types of green financial products and taken a leading role in producing green bonds, green “loan-debt-fund portfolio” and other innovative financing models. In 2015, the CDB joined the newly-founded Green Finance Committee under China Society for Finance & Banking as one of its first standing members. It formed the first team with the IFC and the Industrial and Commercial Bank of China (ICBC) to conduct research in financial product and service innovation. In March 2016, the CDB was the lead underwriter of the country’s first single non-financial enterprise green bonds; in May, the CDB became the lead underwriter of the first green perpetual bond in the country; and in July, the CDB was the lead underwriter of the first green multilateral bond. In October 2016, CDB served as the lead underwriter of the medium-term note of the “debt-loan-fund portfolio” for the Wuhan Metro Group Co., Ltd., and served as the comprehensive financing coordinator to manage the source, disposal and repayment of project funds through a comprehensive integration of bonds, CDB’s medium-and long-term loans and CDB Development Fund and CDB Capital’s funds.

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2.3 THE ENVIRONMENTAL AND SOCIAL POLICIES OF THE WORLD BANK AND THE INTERNATIONAL FINANCE CORPORATION

The WB and the IFC are both subsidiaries of the World Bank Group. They serve respectively as a credit provider and a mobilizer of investment and financing activities, to realize the Group’s missions of “ending extreme poverty by 2030 and boosting shared prosperity in a sustainable manner.” Both play an equally important role in global development projects. The WB and the IFC are pioneering financial institutions to pay attention to environmental issues. Their environmental and social policies and standards set good examples for other financial institutions to follow and created profound influence amongst financial institutions across the world.

The Environmental and Social Policies of the World Bank

The World Bank started to pay attention to environmental and social affairs in the 1870s when environmental issues were placed on global governance agenda. In 1969, the WB appointed its first environmental adviser and in 1970 established the Office of Environmental Affairs. In 1984, the World Bank launched Operational Manual Statement on Environmental Aspects of World Bank Work24, heralding the integration of the environmental and social impacts into the bank’s operating procedures. In 1987, for the first time, the Bank formulated regulations on environmental assessment in its Operational Directive 4.00. Since then, a set of operational directives have been made, updated and amended by the bank to evaluate and manage the environmental and social impacts.

In 1997, the World Bank proposed the Environmental and Social Safeguard Policies as its major regulations for the prevention and control of adverse environmental and social impacts. The Safeguard Policies are made up of Operational Policies (OP) and Bank Procedures (BP). The OP laid out environmental and social requirements and BP provided guidance for the banking staff on the measures to be taken in the process of project approval, preparation, assessment, implementation, and after project completion. Safeguard Policies are composed of five environmental policies, three social policies and two legal policies, all of which are applicable to the WB’s investment and loan projects, Development Policy Loans (DPLs) and Program for Results (PforR). 25 Since its inception in 1997, the Safeguard Policies have undergone constant improvements and have been in use to this day. Among all those policies, the OP/BP 4.01 Environmental Assessment is a programmatic document for the prevention and control of environmental and social impacts. Borrowers should not only comply with the laws and regulations of the host country, but also carry out environmental assessment in accordance with the OP 4.01. OP/BP 4.01, together with the other nine safeguard policies, provides protection of the environment and the vulnerable groups, and minimizes the adverse impacts of the projects funded by the WB (Table 2-4).


## Table 2-2: The World Bank’s Safeguard Policies

<table>
<thead>
<tr>
<th>Policy Type</th>
<th>Policy Title</th>
<th>Main Content</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental</td>
<td>OP/BP 4.01 Environmental Assessment</td>
<td>Through the implementation of the OP/BP 4.01, the WB aims to determine the potential environmental and social impacts of its supported projects, make sure whether other safeguard policies should be applied (e.g. the involuntary resettlement policy) and propose measures to mitigate the impacts. It classifies the proposed project into one of the four categories including Category A, Category B, Category C and Category Fl, depending on the scale of its environmental and social impacts. The borrower should make an environmental assessment in accordance with the environmental policies of the host country and the requirements provided in the OP 4.01, including environmental impact assessment, alternative analysis and plan making for environmental management. For projects classified as Category A and Category B, it should make public consultation and disclose relevant information to the public.</td>
</tr>
<tr>
<td></td>
<td>OP/BP 4.04 Natural Habitats</td>
<td>According to OP/BP 4.04, the WB does not support projects that involve significant conversion or degradation – of “critical natural habitats.” The World Bank also does not support projects involving the significant conversion of natural habitats unless there are no feasible alternatives for the project and its siting, and comprehensive analysis demonstrates that overall benefits from the project substantially outweigh the environmental costs.</td>
</tr>
<tr>
<td></td>
<td>OP/BP 4.09 Pest Management</td>
<td>The objective of the OP/BP 4.09 is to promote pest management methods such as biological treatment and environmental treatment, and to reduce the use of agro-chemicals. Apart from its support for biological treatment for pest management, the OP/BP 4.09 has also provided criteria to apply to the selection and use of pesticides in its supported projects, requiring that pesticides procured through its financing support</td>
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</tbody>
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28 The “Critical Natural Habitats” Defined by the World Bank Include: existing protected areas and areas officially proposed by governments as protected areas, areas initially recognized as protected by traditional local communities, sites that maintain conditions vital for the viability of these protected areas, and sites identified on supplementary lists prepared by the Bank or an authoritative source determined by the Regional environment sector unit.
must be manufactured, packaged, labeled, handled, stored, disposed of, and applied according to standards acceptable to the World Bank.

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<tr>
<th>OP/BP 4.36 Forests</th>
<th>The objective of the OP/BP 4.36 is to assist borrowers to harness the potential of forests in a sustainable manner and protect vital forest resources. The WB does not support finance projects that would involve significant conversion or degradation of critical natural habitats, including projects that involve commercial harvesting related to critical forests or critical natural habitats. If a project involves the significant conversion or degradation of natural forests or related natural habitats that the Bank determines are not critical, and the Bank determines that there are no feasible alternatives to the project and its siting, and comprehensive analysis demonstrates that overall benefits from the project substantially outweigh the environmental costs, the World Bank may finance the project provided that it incorporates appropriate mitigation measures.</th>
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</table>
| OP/BP 4.37 Safety of Dams | The OP/BP 4.37 provides safety measures to be complied with by the projects that involve new dams, existing dams and dams under construction, to ensure that for the life of any dam, the borrower takes appropriate measures and provides sufficient resources for the safety of dams. The policy highlights the role of an independent panel of experts in investigation, design, construction and initial review. Where appropriate, as part of policy dialogue with the country, World Bank staff discuss any measures necessary to strengthen the regulatory frameworks for dam safety programs in the country.  

Social

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<tr>
<th>OP/BP 4.11 Physical Cultural Resources</th>
<th>The objective of the OP/BP 4.11 is to promote the protection of physical cultural resources and avoid or minimize, as much as possible, the damage caused by the projects supported by the World Bank to physical cultural resources, such as historical relics and unique natural scenery. According to its policy requirements, the World Bank does not finance projects that involve significant damage to physical cultural resources, and where the projects involve physical cultural resources, protection should be provided and improvement be made.</th>
</tr>
</thead>
<tbody>
<tr>
<td>OP/BP 4.12 Involuntary Resettlement</td>
<td>The OP/BP 4.12 applies to projects that result in involuntary resettlement because of relocation or losses of land, assets or income sources. This policy requires that involuntary resettlement should be avoided where feasible, or minimized. Where it is not feasible to avoid</td>
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</table>

resettlement, the borrower should assist displaced persons in their efforts to improve their livelihoods and standards of living or at least to restore them, in real terms, to pre-displacement levels.

| OP/BP 4.20 Indigenous Peoples | According to OP/BP 4.20, The projects supported by the World Bank should bring about culturally appropriate social and economic benefits for indigenous peoples, and avoid, or if not feasible, minimize, adverse effects. If indigenous peoples are identified in the project area, or relation of dependence is identified between indigenous peoples and the project, the borrower should conduct social impact assessment on the project, and in every stage of project preparation and implementation, provide all relevant information in a culturally appropriate manner. The World Bank finances projects only after the borrower has conducted free, prior and informed public consultations and won support from affected indigenous communities for the project. Damages should be paid to the indigenous peoples who have suffered losses from the project. |

| Legal OP/BP 7.50 Projects on International Waterways | The objective of the OP/BP 7.50 is to avoid environmental and social impacts caused to the countries along the international waterways involved in international waterway projects, as well as the international disputes caused therefrom. The policy provides measures to be taken by the World Bank and the borrower and a mechanism for communication with the countries along the international waterways. |

| OP/BP 7.60 Projects in Disputed Areas | According to the OP/BP 7.60, only if the two sides to the disputed area have no objection to the project or under special circumstances, should the World Bank warrant support of the project. Such special circumstances are specified in the policy. |

The high recognition of information transparency and the great importance attached to it by the WB helped the implementation of the safeguard policies. According to the WB, information disclosure is the prerequisite to public participation and supervision in ensuring the transparency of projects. It will not only help the project identify potential problems, but also bring more comprehensive solutions to solve such problems. In this sense, information disclosure could play a key role in strengthening good governance, improving operation effects and realizing poverty reduction. In 1994, the WB published the first information disclosure policy, based on which updates were made in 2002 and 2010 to expand the scope of information to be disclosed, in an attempt to improve the openness, transparency and accountability of the WB.

According to *World Bank Policy on Access to Information* launched in 2010, the WB will make public all the information in its possession that is not on its list of exceptions. The disclosed information
includes but are not limited to: the WB’s “Operational Policies” (OP) and “Bank Procedures” (BP); “Project Information Document” (PID) for pending projects; “Project Appraisal Document” (PAD) for projects currently being financed; the “Environmental Assessment Reports” (EA) accessible to project-affected groups and local NGOs in accordance with OP/BP 4.01; “Resettlement Instruments” (RIs) and “Indigenous Peoples’ Development Plans” (IPDPs) submitted by the borrower in accordance with OP/BP4.12 and OP/BP4.20; major decisions made in project development and implementation processes, including decisions made at project concept review conferences and in project supervision and mid-term project reviews; the “Implementation Completion Report” (ICR) available after the project is completed; the “Project Performance Assessment Reports” (PPARs) and the “Impact Evaluation Reports” (IERs) designed for projects selected by assessment departments.

The information disclosed by the WB is available on its official website and more than 100 public information centers across the world. For information not available on the websites, the public may submit online request and the bank will confirm receipt of the request within five working days and offer comprehensive replies under normal circumstances, or it will provide a comprehensive response to requests within 20 working days, in case of complex requests that may need additional time. The requester can file an appeal if he or she can show that the bank has violated the Policy on Access to Information by improperly or unreasonably restricting access to information that it would normally disclose under the Policy.

Recognizing the factors including the changing borrower profiles, increased awareness of the value and vulnerability of the global commons, changing operations of the bank and the growing role of the private sector, the WB launched the review and update of the environmental and social policies in 2012. The review and update was built on the existing core principles of the safeguard policies. Through understanding the borrowers’ needs and consulting with a broad range of stakeholders, the review aims to establish a comprehensive environmental and social safeguard framework including principles, policies, procedures and directives. It will facilitate the general progress of sustainable development policy development in borrowing countries and improve the lending efficiency of the WB.

In August 2016, the WB’s Board of Executive Directors approved a new Environmental and Social Framework (ESF). The framework introduced comprehensive labour and working condition protections and community health and safety measures that address road safety, emergency response and disaster mitigation. The responsibility of the WB and of the borrower is given a clear-cut distinction in the framework, which also requires the stakeholder engagement throughout the project cycle. The WB plans to start a preparation and training period for 12-18 months to prepare for the transition to the new framework, which is scheduled to go into effect in early 2018.


current safeguards are expected to run in parallel to new ESF for about seven years to govern approved projects before the effectiveness date of the new ESF. 32

The Environmental and Social Policies of the International Finance Corporation

The IFC has made stringent environmental and social policies and standards to regulate investment activities for the private sector, and these policies and standards have undergone constant reviews and updates. The environmental and social policies and standards currently used by IFC were updated in 2012 and have three parts: the International Finance Corporation’s Policy on Environmental and Social Sustainability (Sustainability Policy), the International Finance Corporation’s Performance Standards on Environmental and Social Sustainability (Performance Standards), and the International Finance Corporation Access to Information Policy (Access to Information Policy).

IFC’s Policy on Environmental and Social Sustainability is a set of governing policies for the environmental and social management of IFC-supported projects. It points out IFC’s efforts to carry out investment and advisory activities with the intent to ‘do no harm’ to people and the environment, to enhance the sustainability of private sector operations and the markets they work in, and to achieve positive development outcomes. The Sustainability Policy introduces the functions and requirements of the Performance Standards and the Access to Information Policy, and specifies IFC’s environmental and social obligations and responsibilities. 33

The Performance Standards lays out the environmental and social requirements for its clients, and reviews and manages the environmental and social risks and impacts. It specifies standards in eight areas, including labour and working conditions, resource efficiency and pollution prevention, community health, safety and security, land acquisition and involuntary resettlement, biodiversity conservation and sustainable management of living natural resources, indigenous people, and cultural heritage. In the case of direct investment (including project and corporate finance provided through financial intermediaries), IFC requires its clients to apply the Performance Standards to manage environmental and social risks and impacts, and comply with applicable national laws, including international laws that are adopted and approved by host countries. 34

The IFC will carry out due diligence against the Performance Standards for intended investment projects, and will only provide financial support for the projects that are expected to meet the requirements of the Performance Standards within reasonable time. The IFC will also assist its clients in identifying opportunities to improve their environmental and social performances and taking measures in accordance with the Performance Standards to prevent environmental and social impacts. For instance, the Guidance Notes and the Interpretation Note on Financial Intermediaries

offer guidance for clients on how to implement the Performance Standards. Throughout the life of a project, IFC will monitor the environmental and social performances of its clients. Project appraisal conducted by IFC will follow the general and industry-specific good international practices listed in the technical reference documents of the Environmental, Health and Safety Guidelines (EHS Guidelines). When host country regulations differ from the levels and measures presented in the EHS Guidelines, projects are expected to achieve whichever is more stringent.  

The Access to Information Policy provides IFC’s commitment to transparency and specifies IFC’s policy regarding the scope of information that it makes available to the public either as a routine matter or upon request. The information IFC makes available in accordance with the Access to Information Policy can be categorized as institutional information about IFC and project-level information regarding investments and advisory services supported by IFC, which would enable its clients, partners and stakeholders (including Affected Communities), and other interested members of the public to better understand IFC’s business activities, development outcomes and other impacts of its activities. For each proposed investment, IFC will disclose a Summary of Investment Information (SII), which provides basic information about the project or investment, as well as the environmental and social impacts of the project. For projects and investments with potential significant adverse environmental or social risks and/or impacts, IFC will endeavor to provide access to the draft Environmental and Social Impact Assessment (ESIA) prepared by the client even before IFC has started the review of its investment. 

It should be noted that IFC’s environmental and social policies have exerted profound influence upon environmental and social standards adopted by the financial sector and have also been widely acknowledged by the private sector. The IFC requires not only its directly invested projects to abide by the Performance Standards, but also those financial intermediaries in collaboration with IFC to develop and operate an Environmental and Social Management System (ESMS) that is commensurate with the level of environmental and social risks in their portfolio and prospective business activities. The ESMS should incorporate relevant principles of the Performance Standard 1: Assessment and Management of Environmental and Social Risks and Impacts. By the end of 2016, 85 financial institutions from 35 countries have adopted the Equator Principles, a framework based on IFC’s Performance Standards on Environmental and Social Sustainability, to assess and manage environmental and social impacts and risks in project financing. The WB, in its newly launched Environmental and Social Framework, has substituted 10 safeguard policies with 10 environmental and social standards, amongst which the first to the eighth environmental and social standards have adopted the framework of the Performance Standards.

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35 Ditto.

The Supporting Measures of the World Bank and the International Finance Corporation for Green Investment

On the one hand, the WB and the IFC have been committed to improving their environmental and social policies to prevent adverse environmental and social impacts from their investment activities, and on the other hand, they have also devoted themselves to supporting green investment by issuing green bonds and granting loans to support the management of environmental and natural resources.

In 2016, the International Bank for Reconstruction and Development (IBRD) issued USD 3.75 billion of loans for the management of environmental and natural resources, and the International Development Association (IDA) issued USD 1.12 billion of loans for the same purpose, accounting for 12.6% and 7.7% of the total new loans issued that year by the two institutions respectively. The IBRD is the pioneer and largest issuer of green bonds and has issued 125 green bonds since 2008, raising USD 9 billion. The funds are mainly raised for adaptation and mitigation projects to cope with climate change, involving solar and wind powers, energy-efficient buildings and sustainable forest management, etc. The IFC launched its green bond programme in 2010, and from 2010 to 2016 a total of USD 5.7 billion of green bonds has been issued, raising funds for energy efficiency, renewable energy, resource efficiency, clean technology production and sustainable forestry.

2.4 THE ENVIRONMENTAL AND SOCIAL POLICIES OF THE JAPAN BANK FOR INTERNATIONAL COOPERATION

As Japan’s policy bank, the Japan Bank for International Cooperation actively develops overseas business and teams up with Japanese companies in overseas investment projects. It has established 16 overseas representative offices in cities such as Bangkok, Beijing, London, Manila, Mexico City, New York, and Singapore. Over the recent years, JBIC has paid more attention to issues in the environmental protection area and formulated its own environmental and social policies with reference to the policies of the WB and the United International Bank. Gradually JBIC shifted its overseas priority financing area to environmental protection. By March 2015, JBIC’s capital has reached USD 13.51 billion, its outstanding loans and equity participation has amounted to USD 142.71 billion and its outstanding guarantee has reached USD 24.98 billion. 64% of the bank’s loans, equity participations and guarantee commitment funds are used to support, maintain and improve

41 IFC Green Bond Impact Report 2015.
42 Ditto.
the international competitiveness of Japanese industries; 33% is used to promote the exploration and securement of important overseas resources for Japan; and 3% is used to develop overseas business with the purpose of environmental protection such as global warming prevention.43

**Environmental and Social Policies**

JBIC has been strongly criticized before for the adverse environmental and social impacts caused by the projects under its support, e.g. the Kotopanjan Dam project in Indonesia and the wastewater management project in Samut Prakarn, Thailand in 1990s. JBIC’s setbacks in the developing countries can be imputable to the lack of clear-cut evaluation standards, an information disclosure policy, an effective supervision and monitoring mechanism and a rectification system. Having realized the important environmental and social impacts its projects could exert upon the host countries, JBIC launched the *Japan Bank for International Cooperation Guidelines for Confirmation of Environmental and Social Considerations*44 (hereafter referred to as “Environmental Guidelines”) in 2003, to tackle the issues mentioned above.

The *Environmental Guidelines* stipulates the assessment standards for the environmental and social impacts caused by JBIC-supported projects, the environmental and social requirements that projects should meet, and relevant operational procedures. It requires all JBIC-supported projects to be carried out with the purpose of protecting the environment and the society. In July 2009, JBIC amended the *Environmental Guidelines*, expanding the scope of information available to the public, specifying the international standards of environmental and social impacts, and adding contents concerning ecosystem protection, involuntary resettlement and indigenous peoples. Between 2013 and 2014, the second round of review on the *Environmental Guidelines* brought in views from all stakeholders including NGO representatives, related industries and government departments. The current *Environmental Guidelines* came into effect in January 2015.

The *Environmental Guidelines* highlighted the importance of communications among JBIC, the government of the host country, borrower, and project proponent in order to determine the right measures for environmental and social protection with the engagement of affected local residents and NGOs. It stressed the importance of transparency during the whole process. The *Environmental Guidelines* requires that before determining whether to support a project, JBIC should classify projects into one of the categories of A, B, C and FI based on the degree of their environmental impacts, and environmental assessment should then be conducted in line with the environmental and social requirements outlined in each category to confirm whether appropriate measures have been taken to prevent and control adverse impacts (Table 2-3).

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Table 2-3: Environmental Categories and Assessment Requirements

<table>
<thead>
<tr>
<th>Category</th>
<th>Definition</th>
<th>Assessment Requirements</th>
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</thead>
<tbody>
<tr>
<td>Category A</td>
<td>A proposed project that is likely to have a significant adverse impact on the environment.</td>
<td>JBIC will assess the potential adverse environmental and social impacts of a project and the corresponding measures for the prevention and control of such impacts. The assessment will be undertaken on the basis of the following documents submitted by the borrower: Environmental Impact Assessment (EIA) reports and environmental permit certificates issued by the host governments; for projects that will result in large-scale involuntary resettlement or projects that will require measures for indigenous peoples, resettlement action plans, livelihood restoration plans and indigenous peoples’ plans.</td>
</tr>
<tr>
<td>Category B</td>
<td>A proposed project that its potential adverse environmental impact is less adverse than that of Category A projects.</td>
<td>JBIC will assess the potential adverse environmental and social impacts of a project and the corresponding measures for the prevention and control of such impacts. Category B projects are similar to those of Category A in terms of assessment, but the scope of environmental reviews for Category B projects is narrower. Where an environment impact assessment procedure has been conducted, JBIC may refer to the EIA reports and permit certificates. However, this is not a mandatory requirement.</td>
</tr>
<tr>
<td>Category C</td>
<td>A proposed project that is likely to have minimal or no adverse environmental impact.</td>
<td>For projects in this category, JBIC does not undertake environmental reviews beyond screening.</td>
</tr>
<tr>
<td>Category FI</td>
<td>A proposed project that satisfies all of the following: JBIC’s funding of the</td>
<td>JBIC checks through the financial intermediary to see whether appropriate</td>
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project is provided to a financial intermediary; the selection and assessment of the actual sub-projects is substantially undertaken by such an institution after JBIC’s approval of the funding, and therefore, the sub-projects cannot be specified prior to JBIC’s approval of funding (or assessment of the project); and those sub-projects are expected to have potential impact on the environment.

| environmental and social considerations as stated in the Guidelines are ensured for projects in this category. |

To conduct environmental impact assessment and ensure proper environmental and social protection measures are in place, JBIC refers to not only the environmental laws, regulations, standards and plans of the host country, but also IFC’s *Performance Standards on Environmental and Social Sustainability* and the World Bank’s *Environmental, Health and Safety Guidelines*. If the environmental review shows that the environmental and social protection measures are deficient, JBIC will urge the project to undertake appropriate environmental and social considerations. If the project fails to take these considerations, JBIC might not make the investment or provide the loans.

After the loan is approved, the borrower’s obligations for environmental and social protection will be included in its loan contract. For instance, the borrower shall report to JBIC on measures and monitoring related to environmental and social considerations undertaken by the project proponents; if any problems regarding environmental and social considerations arise, the borrower shall make efforts for discussions to be held between the project proponents and project stakeholders. In the process of post-loan management, JBIC will monitor the actual implementation of environmental and social considerations for Category A and B projects, so as to ensure relevant considerations are effectively implemented. If JBIC judges that environmental and social considerations are not appropriately implemented, it may ask the project proponent to take appropriate action. If the response of the project proponent is inappropriate, JBIC may suspend its investment and loans, or require the borrower to repay the loans in advance.

JBIC welcomes information provided by stakeholders, so that it may conduct more comprehensive reviews and monitoring of environmental and social impacts and considerations. In accordance with the *Environmental Guidelines*, JBIC discloses the name, country, location and category classification of the project, and for Category A and B projects, the EIA reports and permit certificates. For Categories A, B, and FI projects, JBIC discloses results of environmental reviews and results of the monitoring conducted by the project proponents after signing the loan agreements.

**Supporting Measures for Green Investment**

On the one hand, JBIC has constantly improved its *Environmental Guidelines* to prevent and control adverse environmental and social impacts caused by JBIC-supported projects. On the other hand,
JBIC pushes forward green investment projects by providing preferential loan policies for projects that aim to protect and improve the environment and establishing special mechanisms and business services.

In April 2008, JBIC launched “JBIC Facility for Asia Cooperation and Environment” (FACE) to strengthen its support for Asian developing countries to cope with climate change. Three years later, JBIC developed and expanded FACE and transformed it into “Enhanced Facility for Global Cooperation in Low Carbon Infrastructure and Equity Investment” (E-FACE), under which the bank aims to mobilize private sector funding to the largest extent and promote strategic projects such as overseas systematically integrated infrastructure projects.

In March 2010, JBIC launched the Global action for Reconciling Economic growth and Environmental preservation (GREEN), in an attempt to work in cooperation with international organizations and local financial institutions in developing countries to provide support for projects with a focus on environmental conservation and renewable energies, such as those anticipated to make contribution to reducing greenhouse gas.

Since the reform in 2012, as one of the main missions of JBIC, it has promoted the prevention of global warming and other overseas businesses aimed at protecting the environment. In fiscal year 2014, 3% of its loans, equity participations and guarantee commitment funds were devoted to overseas business with the purpose of preserving global environment.
3. A COMPARISON OF ENVIRONMENTAL AND SOCIAL POLICIES BETWEEN CHINA’S POLICY BANKS AND INTERNATIONAL FINANCIAL INSTITUTIONS

3.1 WEAKNESSES OF THE ENVIRONMENTAL AND SOCIAL POLICIES OF CHINA’S POLICY BANKS

A comparison of the environmental and social policies between the CDB and the China Exim Bank and those of the WB, the IFC and the JBIC shows the immaturity of China’s policy banks and the need for them to draw experiences from advanced international practices for self-improvement. The main weaknesses include: there is no environmental and social department established; there is no tailored and specific policies for environmental and social issues, and the adopted environmental and social standards are not strict enough; there is no urge for improvement during the pre-loan review and no independent field visit in project management and supervision phases; and there is no complaint mechanism while the information disclosure system needs improvement. Moreover, the CDB has not yet followed the international norms to classify projects in terms of environmental risks, and lacked public consultations with the community affected by the project.

No specific classifications for different environmental and social issues

Regarding environmental and social policies, the WB has made a relatively detailed classification and stipulation on different issues. Its environmental policies involve environmental assessment, natural habitats, pest management, forest and safety of dams; its social policies involve physical cultural resources, involuntary resettlement and indigenous peoples; legal policies involve projects on international waterways, and projects in disputed areas. The new Policy Framework introduced comprehensive labour and working condition protections and community health and safety measures that address road safety, emergency response and disaster mitigation. Similarly, IFC stipulates in its Performance Standards that the assessment and management of environmental and social risks and impacts should be measured in eight aspects, including labour and working conditions, resource efficiency and pollution prevention, community health, safety and security, land acquisition and involuntary resettlement, biodiversity conservation and sustainable management of living natural resources, indigenous peoples and cultural heritage. The relevant policies of JBIC are mainly focused on: 1. people’s health and safety and natural environmental issues: air, water, soil pollution, water use, ecosystems and biological communities, as well as cross-border and global environmental issues; 2. social issues: human rights protection, involuntary resettlement, indigenous peoples, cultural heritage, landscape, gender, child rights, infectious diseases, and community health and safety.

In contrast, the environmental and social policies of the CDB and the China Exim Bank have a narrower scope and the issues are not specifically classified. The environmental and social aspects clearly stated by China Exim Bank include energy conservation and emission reduction (to support the national industrial plan), biodiversity conservation and sustainable natural resource management, as well as land acquisition and involuntary resettlement. CDB’s environmental and
social policies are mainly concerned about issues such as pollution prevention and control, health and migration.

**No specialized environmental and social department**

The WB set up an Office of Environmental Affairs shortly after hiring its first environmental advisor in 1969. 46 The IFC has a dedicated environmental and social governance department to help clients understand and manage environmental and social risks.47 JBIC’s credit sector has also established an Environmental Assessment Office. However, similar arrangements were not found in the institutional setting of the China Exim Bank and the CDB. Without a dedicated department, it is impossible to ensure the development and implementation of environmental and social review, supervision and evaluation, causing ambiguity of authority and responsibility.

**Lenient environmental and social standards**

The environmental and social standards adopted by the WB, the IFC and the JBIC include not only laws and policies of the host country but also the environmental and social norms developed by themselves. In the event that the standards are inconsistent, the WB and the IFC follow the stricter one and adopt the more stringent standard of the two, and JBIC will also refer to the environmental and social standards followed by WB and IFC.

Although the CDB and the China Exim Bank, like other international financial institutions, clearly require that the projects shall abide by relevant environmental and social laws and policies of the host country, there is a lack of further stringent requirements. Only in the absence of such standards would China Exim Bank consider applicable standards in China and international practice; CDB’s environmental and social standards are also mainly based on the host country’s laws and policies. Generally speaking, China’s policy banks adopt a more lenient lending principle than other international financial institutions.

**The pre-loan review lacks support to improve project’s environmental and social plans**

Following customary practices in the industry, China’s policy banks will conduct a pre-loan review to assess the environmental and social risks of the project, and like the IFC and the JBIC, they will use the review results as gauge for the investment. However, the WB, the IFC, and the JBIC also include steps to improve the project during the review process: the WB will assist the project with huge environmental social risks to find an alternative and formulate an environmental management plan; the IFC will help clients without capacity to manage environmental and social risks to formulate improvement plans; the JBIC will assess the project’s environmental and social measures, give suggestions to those with weak protection measures, and only refuse to offer investments or loans to the projects that fail to make such improvements as suggested. In contrast, the CDB and the China Exim Bank will decide whether to grant credit and financial support directly based on the review

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46 Jeremy J. Warford, Zeinab Parton. *Evolution of the World Bank’s Environmental Policy.* http://www.cfe.ph.cn/cfe.ph/finance.nsf/102009b942f90464825672e001a1f8a8/1a1f8a8748256820001f3979

results, without providing any assistance in improving the environmental and social plans of the project.

CDB does not classify projects according to environmental and social risks

The China Exim Bank, the WB, and the JBIC classify their clients according to environmental and social risks, and set special requirements for high-risk projects. The WB requires class A and B projects to do public consultation and information disclosure. The JBIC requires projects in class A, B and F1 to assess environmental and social protection measures and will monitor the implementation of class A and B projects, and establish an expert committee to provide consultations and suggestions for projects with potential of substantial negative environmental impacts. The IFC, though without explicitly defined classification of clients according to environmental and social risks, will also pay special attention to high-risk projects. For example, the IFC will provide support for community at different levels and disclose the environmental and social impact assessments prepared by clients. Similar to the WB and the JBIC, China Exim Bank also conducts special environmental and social risks assessments on class A and B projects, and includes the post-loan assessments in the inspection report. Class A projects will have to solicit public consultation as required by the host country, and the borrower will need to establish a grievance-responsive mechanism, a communication channel with stakeholders, and an emergency plan for serious environmental risks, and carry out regular special inspections during the life of the project.

The CDB has not yet developed a special project environmental classification standards. In 2015, the CDB proposed to follow the principle of tailored management, integrating environmental and social risk management into the credit rating and credit assessment process, and making a “list of key industry clients with environmental and social risks” for industries with relatively bigger environment and social impact.

Lacking independent field visit in the management and supervision of project operations

Like the IFC and the JBIC, the CDB and the China Exim Bank also conduct supervision during the operation and management of the projects. The WB has not yet enacted such regulations. The IFC monitors clients’ social and environmental performances throughout the life of the project: on the one hand, the IFC carries out field visits to the project; on the other hand, clients are required to submit monitoring reports on a regular basis; moreover, the compliance department also provides additional supervision. JBIC supervises the actual implementation of class A and B projects based on the reports submitted by the borrowers, and will launch investigation if necessary (in case of report by a third party).

In contrast, China’s policy banks rely on the information and reports provided by borrowers to conduct supervision upon the environmental impact of the projects. The China Exim Bank conducts the audit of the borrower’s energy consumption and environmental compliance at the time of the first and subsequent issuance of the loan funds, and inspects and supervises the construction and operation of the project according to the environmental and social impact assessment results of the project. Although the CDB has set up a risk-tracking forecasting and feedback mechanism, its environmental impact assessment (EIA) risk monitoring is also achieved through the borrower'
periodic reports on environmental and social risk management and prevention. Neither policy banks of China have formulated requirements for field visit on environmental and social impacts in their environmental and social policies.

Relatively unsound information disclosure system and lack of complaint mechanism

The WB, the IFC, and the JBIC have all made explicit provisions on the information disclosure in their environmental and social policies. Among them, the WB and the IFC have developed specific information disclosure policies. The WB has the widest scope of disclosed information (anything that is not on its list of exceptions), followed by the IFC (including routine public information and information required by the public), and the JBIC only requires disclosure of basic information about the project and related documents and reports. Also, the WB has the most diversified channels for information disclosure: apart from its official website, it has more than 100 public information centers and public application channels. The IFC and the JBIC mainly use their official websites to disclose information. In addition, the WB and the IFC also provide complaint mechanisms for information disclosure.

In contrast, the CDB and the China Exim Bank have not yet established a mature information disclosure system and a complaint mechanism, and information disclosure is missing in their environmental and social policies. In practice, there is no online searching function for environmental and social information and documents of the projects on the official websites of the CDB and the China Exim Bank. The CDB even chooses not to publicize most of its environmental and social policy documents.

CDB lacks open communication and consultation mechanisms with local communities and stakeholders

All five financial institutions except the CDB have included public consultation with the communities affected by the project in their environmental and social policies. The WB requires borrowers to conduct free and informed public consultation in advance and only provides financing for projects that are broadly supported by the affected indigenous community. The JBIC requires in its Environmental Guidelines that the project should attach importance to dialogues with stakeholders and transparent participation of the affected indigenous community. The China Exim Bank requires class A projects to solicit public consultation as required by the host country, and requires the borrower to establish a complaint response mechanism and a communication mechanism with stakeholders. The CDB has not yet publicized such regulations, nor established any effective communication mechanism with local communities. Especially when specific environmental and social issues emerge in the life of the project, no consultation channel with affected communities will lead to people’s complaints.

3.2 PROGRESSIVENESS OF THE ENVIRONMENTAL AND SOCIAL POLICIES OF CHINA’S POLICY BANKS

Compared with the WB and other international financial institutions, China’s policy banks still have a long way to go to improve environmental and social policies. However, the CDB and the China Exim Bank have made pioneering attempts to develop world-leading regulations. The two banks’ requirements for environmental and social risk control and for the related review documents are much clearer and more standardized. They also have stricter punishments for violating environmental regulations. In addition, the CDB and the China Exim Bank have also taken some constructive measures in support of green investment.

*Better control of environmental and social risks*

The CDB and the China Exim Bank, like their international counterparts, have included environmental and social responsibilities in the contracts to control the environmental and social risks and impacts. The control goes through every segment of the investment project from pre-loan to post-loan, the same standardized process as other international financial institutions. In fact, China’s policy banks have more refined procedures than the IFC or the JBIC. The CDB and the China Exim Bank have divided environmental and social risks control into specific and clear-cut segments, including pre-loan investigation, loan review, contract management, loan issuance and post-loan management. They also require an EIA after the completion of the project and the CDB went even further to introduce a standard review procedure, which is more advanced than the current procedures of the WB and the IFC.\(^49\) In contrast, IFC and JBIC have defined their controlling procedures in a relatively broad way, though control of environmental and social risks go through a whole process from pre-loan to post-loan for both banks. The IFC requires both pre-loan and post-loan investigations and overall supervision of an investment project. The JBIC only requires pre-loan review and post-loan follow-up to control environmental and social risks, in short of further definition and specification.

*Specified requirements for review materials and documents*

CDB, China Exim Bank and JBIC have clear requirements for the types of documents to be submitted for project review and approval. JBIC also requires that the types of materials might vary from project to project depending on the environmental and social risk assessment ratings. CDB provides that the borrower must obtain the EIA document officially approved by the host country (region) before the loan contract is signed.\(^50\) China Exim Bank requires the client to provide review documents issued by relevant departments in the host country, environmental and social impact assessment report, and written opinion in the credit granting review report by relevant department specifying the environmental and social risks of the client (including Pre-review). JBIC provides that class A projects shall submit Environmental and Social Impact Assessment reports and environmental permit certificates issued by the host government or other appropriate authority. For projects that

\(^49\) Paulson Institute: Profiting from Precaution.

\(^50\) China Development Bank: “Green Development for Mutual Benefit and Win-win Results – A Record of CDB’s Overseas Green Credit Business”. 
will result in large-scale involuntary resettlement or loss of means of livelihood, resettlement action plans should be submitted, including livelihood restoration plans and indigenous people’s plans where necessary. Class F1 projects shall submit the classification and assessment results provided by financial intermediaries, and class B projects shall submit materials voluntarily. Class C projects have no need to provide materials concerning environmental issues. According to policies of the WB and the IFC, the clients can voluntarily submit documents and key information concerning environmental and social assessment. To conclude, policy banks in China and Japan have stricter and more specific requirements on the review materials while the WB and the IFC are more flexible.

More stringent punishment measures for violations against environmental regulations

When it comes to the response and punishment mechanisms against the environmental and social risks discovered in the monitoring, CDB, China Exim Bank, IFC and JBIC will all issue early warning or urge rectification first. For the projects that fail to rectify as required, CDB, China Exim Bank and JBIC have set further punishments, among which the two China’s policy banks are more stringent. If the project fails to rectify as required, China Exim Bank will stop providing credit support and will consider the project with such environmental and social risk management condition as non-performing loans and bad debts. CDB will downgrade the asset level, limit the loans and even stop providing loans to the enterprise for violating environmental regulations or causing severe safety accidents.51 JBIC will also suspend issuance of fund for projects whose environmental and social measures are not in place. Setting up powerful punishment measures helps urge borrowers to fulfill their environmental and social responsibilities and mitigate negative impacts.

Efforts in support of green investment

Like WB, IFC and JBIC, both CDB and China Exim Bank have specialized businesses to support green investment and provide preferential policies and convenience for green projects. CDB provides credit support for projects in the areas of pollution prevention and control, renewable energy, energy saving and environmental protection, and modern agriculture, and actively develops new types of financial products such as green bonds and green "loan, debt and fund" and other innovative financing facilities. China Exim Bank has launched express services for green credit approval, energy-saving environmental protection fund, and carbon finance services focused on carbon asset consultation, in an effort to strengthen the support for green and low-carbon recycling economy. The WB has issued a large number of green bonds to support climate investment in developing countries and established a “Green Bond Impact Report” to track and study the use of its earnings. The IFC also provides preferential conditions for projects that are beneficial to environmental protection and improvement, and has set up specialized mechanisms and operations for green investment projects.

51 Ibid.
### Table 3-1: A Comparison of environmental and social policies among five financial institutions:

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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Electricity, highway, railway, petroleum and petrochemical, coal, post and telecommunications, agriculture, forestry and water conservancy, urban public facilities, etc.</td>
<td>Chinese enterprises’ export of mechanical and electrical products, complete sets of equipment, high-tech products exports, foreign contracted projects and overseas investment.</td>
<td>Mainly infrastructure and services in developing countries.</td>
<td>Financial industry, infrastructure construction and agroforestry.</td>
<td>Energy and resources, manufacturing and environmental protection.</td>
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</tbody>
</table>
| Environmental and Social Framework, 2016 (estimated to be enforced in 2018) | Energy conservation, land acquisition and involuntary migration, biodiversity conservation and sustainable natural resource management, etc. | Current policy contains issues of environmental assessment, natural habitats, pest management, indigenous peoples, physical cultural resources, involuntary resettlement, forests, safety of dams, projects in disputed areas, projects on International Waterways. The new framework will also include issues of comprehensive protection of labor and working conditions, general principles of non-

Environmental and social risks and impacts, labor and working conditions, resource efficiency and pollution control, community health, safety and security, land acquisition and non-resource transfer, biodiversity conservation and sustainable management of biological natural resources, indigenous residents, cultural heritage.

Social concerns include respect for human rights, such as involuntary resettlement, indigenous peoples, cultural heritage, landscape, gender, children's rights, communicable diseases, working conditions and community healthy safety.
<p>| How China’s Policy Banks Can Support Sustainable Foreign Investment | discrimination, social health and safety measures for road safety, emergency response and disaster reduction. | and security that may bound energy problems. |
| Project development, credit approval, contract management, post-loan management etc. Supervision will be throughout the credit process. | Pre-loan investigation, loan review, contract management, loan issuance and post-loan management | Project approval, preparation, evaluation, implementation process and after the project. | Risk control is throughout the investment cycle |
| Referring to laws and policies of the host countries. | Evaluation is in line with host countries’ laws and policies, at whose absence the Chinese standard or international practice will be referred to. | Projects shall meet both the requirements of host countries’ laws and policies and OP 4.01. When the two are inconsistent, follow the strictest rules of the standards. | The requirements in the Performance Standard shall be met, details referring to the Environmental, Health and Safety Guidelines. International practices and laws in host country should also be considered. When different standards are inconsistent, follow the strictest one. | Host country policies on IFC’s Environmental and Social Performance Standard: Bank Environment and Safety. |</p>
<table>
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<tr>
<th></th>
<th>N</th>
<th>N</th>
<th>Y</th>
<th>Y</th>
</tr>
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<tr>
<td>W</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
</tr>
</tbody>
</table>

- **EIA document officially approved by host country government.**
- **The approval document of the competent department of the host country, the EIA report, and a written review of the client’s exposure to environmental and social risks in the client’s credit review (including preliminary) report.**
- **Documents contain environmental and social evaluation.**
- **Customers are required to provide key information about asset and environmental social risks and impact management.**
- **Projects in Category A are required to provide the EIA report, Environment Permit Document. Projects resulting in large-scale involuntary resettlement and having an impact on the aborigines shall provide resettlement livelihood recovery plan and the original indigenous program.**
<table>
<thead>
<tr>
<th>FI Category projects</th>
<th>required to provide classification results</th>
<th>Voluntary provision of related materials for B category projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>Y</td>
<td>Y</td>
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<td>Y</td>
<td>Y</td>
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<td>N</td>
<td>N</td>
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</table>

How China’s Policy Banks Can Support Sustainable Foreign Investment

Global Environmental Institute

August, 2017

39
<table>
<thead>
<tr>
<th>ID</th>
<th>Description</th>
<th>Requirements</th>
<th>Disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Advance and dynamic risk warning mechanism. Degradation of asset quality, loan limit and cease of lending for enterprises observed violations of the law and major security accidents.</td>
<td>Require the borrower or project owner to take measures to eliminate the impact in time. Failure to comply with the requirements will stop the credit support. Inadequate environmental and social risk management will also be considered as non-performing loans and bad debts identification.</td>
<td>Disclosure of customers' violation against the Performance Standard, and help them identify opportunities to improve the environmental and social performance of the project.</td>
</tr>
<tr>
<td>2</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
</tr>
<tr>
<td>3</td>
<td>N</td>
<td>N</td>
<td>Y</td>
</tr>
<tr>
<td>4</td>
<td>Not specified.</td>
<td>Not specified.</td>
<td>Information outside the exception list shall be disclosed.</td>
</tr>
</tbody>
</table>

Global Environmental Institute
August, 2017

40
<table>
<thead>
<tr>
<th>Category</th>
<th>Disclosure Channels</th>
</tr>
</thead>
<tbody>
<tr>
<td>A, B, F</td>
<td>The WB website, more than 100 public information centers, public application channel and complaint mechanism.</td>
</tr>
<tr>
<td>I</td>
<td>IFC website, public application channel and compliant mechanism.</td>
</tr>
<tr>
<td></td>
<td>JBIC</td>
</tr>
</tbody>
</table>
4. CASE STUDIES: ROLE OF POLICY BANKS IN THE PREVENTION AND CONTROL OF ENVIRONMENTAL AND SOCIAL RISKS

In order to further verify the effect of environmental and social policies implemented by China’s policy banks in real practice, a research team of four including GEI staffs and experts went to Colombo, capital of Sri Lanka in March 2017, and visited some Chinese enterprises working on investment and contracting projects in Sri Lanka, and interviewed their general managers and project leaders. During the five days visit, the team interviewed representatives from six state-owned enterprises and one private enterprise, obtained first-hand information about the environmental and social risks these enterprises had come across in Sri Lanka, and conducted in-depth studies in the preventative measures provided by banks’ lending policies. This chapter will discuss two cases involving two projects contracted and invested by Chinese enterprises with financial support from China’s policy banks: Sri Lanka Southern Railway project and Colombo Port City project. Based on field research and interviews with representatives from the Chinese enterprises, the detailed recount includes information on the financing models of the projects, their environmental impact assessment, and the crises of project suspension. It will also look into the implementation of bank’s environmental and social policies in the projects and analyze the remaining challenges for current policies in preventing and controlling environmental and social risks.

4.1 ABOUT SRI LANKA

Statistics on China’s investment and contracting in Sri Lanka

Statistics from China’s Ministry of Commerce show that China’s non-financial foreign direct investment flow in Sri Lanka was USD 75.39 million in 2014. As of the end of 2014, China’s foreign direct investment stock in Sri Lanka stood at USD 477 million. In the past five years, Chinese enterprises have made leap-forward development in investment in Sri Lanka and signed several large-scale investment projects, including Colombo South Container Terminal invested by China Merchants Group, Colombo Port City invested by China Communications Construction Group Co., Ltd., and the AVIC Astoria luxury apartment project in Colombo invested by AVIC International Holding HK Ltd. In addition, investment by Chinese private enterprises in Sri Lanka has seen rapid development in various fields such as hotel, tourism, agricultural product processing, fishery, furniture manufacturing, textile, feeding, biomass power generation, bicycle manufacturing, warehousing and logistics.

According to China’s Ministry of Commerce, in 2014, the newly signed contract amount of Chinese enterprises in Sri Lanka reached USD 2,798 million and the turnover amounted to USD 2,191 million. 1,667 Chinese contract workers were dispatched in 2014 and by the year end, there were altogether 3,350 contract workers in Sri Lanka. Newly signed large-scale project contracting projects include the Gin-Nilwala Diversion Project constructed by China CAMC Engineering Co., Ltd, the Pitigala Dam Project constructed by Sinohydro Corporation, and the consultation for the extension of Sri Lanka’s Southern Expressway contracted by China Railway First Survey & Design Institute Group Ltd.
At present, 47 Chinese enterprises are registered at the Economic and Commercial Counselor’s Office of the Chinese Embassy in Sri Lanka, including China Harbor Engineering, China State Construction Engineering, China Geo-Engineering, Sinohydro Corporation, China National Aero-Technology Import & Export Corporation, ZTE Corporation, and China National Corporation for Overseas Economic Cooperation. Their businesses mainly include contracting projects, investment and trade and other commercial activities.

Chinese enterprises in Sri Lanka are commonly financed through export buyer’s credit and the packaged cross-border financial services provided by domestic banks.

**Sri Lanka’s policies on overseas investment and contract projects**

The Sri Lankan government established a Board of Investment (BOI) to encourage foreign enterprises or governments to invest in Sri Lanka and review and approve overseas investment. Sri Lanka’s major areas for foreign investment include tourism and entertainment, road, bridge, port, electricity, communications, water supply and drainage and other infrastructure construction projects, information technology, textile, agriculture and animal husbandry, import replacement industry and export-oriented industry. There is no restriction on means of investment in Sri Lanka. Foreign enterprises are encouraged to participate in Sri Lanka’s infrastructure construction and invest in any industry through BOT and PPP except for some restricted areas. However, the overseas investment policies may be adjusted, as the government is still in transition after the presidential election and parliamentary election in 2014. Several large-scale projects including some invested and contracted by Chinese enterprises have been suspended. The situation for foreign investment in Sri Lanka needs further observation.

Foreign enterprises are mainly involved in three types of contract projects in Sri Lanka. Each type has its pros and cons for foreign enterprises, as shown in Table 4-1.

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Table 4-1 Contract projects in Sri Lanka and foreign enterprises’ advantages

<table>
<thead>
<tr>
<th>Types</th>
<th>Advantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Projects financed by the owner; local companies are able to contract.</td>
<td>Foreign enterprises are not forbidden by the government to participate, but compared with local companies, they do not have any advantage in winning the contract.</td>
</tr>
<tr>
<td>2. Projects financed by international investment or independent governmental fund; local companies are not able to contract.</td>
<td>Foreign and local contractors can compete in an international bidding. The Sri Lankan government encourages foreign and local contractors to establish joint ventures to participate in the bidding and construction. Once succeeded, they will enjoy preferential tax rates. Both foreign and local enterprises are required to participate and compete according to the bidding procedures.</td>
</tr>
<tr>
<td>3. Private projects invested by individuals or nongovernmental entities.</td>
<td>The bidding of the projects depends on the procedures and regulations of the private owner. Sri Lanka has regulations on foreign companies participating in the project bidding. Foreign company shall pass relevant pre-qualifications and Chinese company shall be certified or recommended by the Economic and Commercial Counselor’s Office of Chinese Embassy in Sri Lanka.</td>
</tr>
</tbody>
</table>

Most projects in Sri Lanka are conducted through international public bidding while some other contractors use financing to negotiate bids, which is not open and competitive because the owner and the contractor reach agreement through one-on-one negotiations.

*Investment risks*

According to the *National Investment and Business Facilitation Status Report 2016* issued by Sino Rating Department of Chinese Export & Credit Insurance Corporation, several rating agencies have given Sri Lanka's sovereign credit rating in 2016 below average and a negative prospect for investment in Sri Lanka. Sri Lanka's Corruption Perceptions Index ranking in 2015 and the World Bank Ease of Doing Business Index ranking in 2017 were also around or below average. Similarly, the *Country-risk Rating of Overseas Investment from China 2016* published by the World History Institute of Chinese Academy of Social Sciences also classified Sri Lanka into average level. The report emphatically cited several reappraised and indefinitely suspended cases, including China-aided port project, as typical daunted or failed investments.
Table 4-2 Ease of investment and business in Sri Lanka

<table>
<thead>
<tr>
<th>Rating Agency</th>
<th>Time of Rating</th>
<th>Sovereign Credit Rating</th>
<th>Prospect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fitch Ratings</td>
<td>2016.3</td>
<td>B+</td>
<td>Negative</td>
</tr>
<tr>
<td>S &amp; P</td>
<td>2016.3</td>
<td>B+</td>
<td>Negative</td>
</tr>
<tr>
<td>Moody’s</td>
<td>2016.7</td>
<td>B1</td>
<td>Negative</td>
</tr>
<tr>
<td>Sinosure</td>
<td>2016.10</td>
<td>CCC(7/9) Stable</td>
<td></td>
</tr>
</tbody>
</table>

2015 Corruption Perceptions Index 83/168
2017 World Bank Ease of Doing Business Index 110/190

4.2 CASE 1: CMC AND SOUTHERN RAILWAY PROJECT (EPC MODE)

About CMC

Founded in 1950, China Machinery Import & Export (Group) Co., Ltd. (CMC) is China’s first large-scale state-owned foreign trade company specialized in import and export of mechanical and electrical products as well as international engineering contracting business. In 1998, CMC became a wholly-owned enterprise of China General Technology (Group) Holding Ltd. under the direct supervision of the central government. CMC’s international engineering and contracting businesses cover various fields, including energy, railway transportation, chemicals, building materials, and shipbuilding. Its business network reaches 160 countries and regions, and it has exported complete sets of large and medium-sized equipment to more than 20 countries and regions. At present, the company has overseas representative offices in 13 countries, including Pakistan, Bangladesh, France, Germany, Indonesia, Iran, Japan, Malaysia, Myanmar, Russia, Sri Lanka, Turkey and Vietnam.

CMC’s representative office in Sri Lanka is mainly specialized in railway, energy, chemical industry, infrastructure construction, large-scale complete-set equipment export and new energy development. Meanwhile, the office is taking the Southern Railway project as an opportunity to make its Phase I a role model project to extend it to Phase II, Phase III and other extension projects. The office endeavors to develop railway projects, energy projects, water treatment projects and ship, vehicles and complete-set equipment export projects in an effort to expand the scope of business and market share of the company in Sri Lanka.  

About the project

The Southern Railway in Sri Lanka starts from Matara of Southern Province and ends in the Kataragama of Uva Province, with a total length of 127 km. The project is divided into three phases. Phase I, from Matara to Beliatta 26.7-km long, led by CMC and co-constructed by China Railway No. 53

5 Engineering Group. The project will build a single-track railway powered by an internal combustion engine, plus stations, tunnels, bridges, and culverts along the railway. The design speed of the train is 120 km/h, the fastest in Sri Lanka’s history. It will be the first railway constructed in the past 90 years in the country. It is expected to help promote the upgrading of the Sri Lanka’s railway network, drive the development of tourism along the railroad, and revitalize the post-war economy in Sri Lanka.

The Southern Railway project is the first railway project contracted by a Chinese enterprise in the form of EPC in Sri Lanka. CMC signed an official agreement on Southern Railway Phase I with the government of Southern Province in 2010 at a contract value of USD 278 million. The project is financed by the “two preferential loans” (Concessional Loan and Preferential Export Buyer’s Credit, see Table 3) provided by China Exim Bank to Sri Lanka’s Ministry of Transport, with USD 200 million in the form of Preferential Export Buyer's Credit and the rest USD 78.2 million in the form of Chinese Government Concessional Loan, at an annual interest rate of 2% and a repayment period of 20 years including a five-year grace period.  

According to CMC’s director in Sri Lanka, the company has tried to open markets in Bangladesh, Sri Lanka and other South Asian countries since 2004 and also tried to promote China Exim Bank’s “two preferential loans” in response to China’s “going out” initiative. After years of marketing and interaction with the local government, CMC finally signed an official agreement with Sri Lankan Government on the Southern Railway project in 2010. In 2013, CMC obtained the loan from China Exim Bank and started construction in August 2013.

Table 4-3 About the “two preferential loans”

<table>
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<th>Description</th>
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<td>China Exim Bank is the only bank appointed by the Chinese government to implement the “two preferential loans”. These two facilities are an arrangement made by the Chinese Government to support other developing countries with concessional funding provided by policy bank’s preferential loans. The “two preferential loans” are the Chinese Government Concessional Loan and Preferential Export Buyer’s Credit. The Chinese Government Concessional Loan refers to the medium and long term, low interest rate loan facility with the feature of government aid and grant. Preferential Buyer’s Credit refers to the loan facility with concessional terms to promote the economic and trade cooperation between China and key countries and regions approved by the State Council. The “two preferential loans” are sovereign debts. The borrower is the sovereign institution of the project or the entity appointed and guaranteed by the sovereign institution. The sovereign institution refers to the Ministry of Finance or the Central Bank.</td>
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Suspension crisis

In January 2015 after Maithripala Sirisena came into office as Sri Lanka’s new President, several large-scale projects endorsed by the former government and invested and constructed by Chinese enterprises were called off, including the Southern Railway project. In August 2015, the Sri Lankan Government declared that CMC did not bid on the project and the cost of the project was beyond estimate, insinuating it was related to the corruption allegations against former President Mahinda Rajapaksa. Accordingly, Sri Lanka’s External Resources Department launched an investigation into several procedural documents including feasibility research and environmental impact assessment.

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54 China will provide loan and support for Sri Lanka Railway. Reuters. 2013.03.05.
http://cn.reuters.com/article/cn-loan-sri-lanka-rrl-idCNCNE9240AU20130305

55 On China’s “Going Out” Strategy and China Exim Bank’s Two Preferential Loans. 2015.10.08.
causing a suspension of more than six months for the project. The contract period was prolonged accordingly. \(^{56,57}\) The project was originally scheduled to be completed by 2016, yet by March 2017 when the GEI team visited the construction site, the construction of Phase I was rushing to completion. The project was now expected to complete by the end of September 2017.

One of the reasons for the suspension is concerned about environmental impact assessment. China Exim Bank specified that when applying for “two preferential loans” the government of the borrower country should submit a feasibility research report (proposal) and an environmental impact assessment report. The feasibility research and environmental impact assessment of the Southern Railway project were conducted by the Sri Lankan government. CMC, as the contractor of the project, was not directly involved in the environmental impact assessment process but was only responsible for urging the government to complete the environmental impact assessment to facilitate China Exim Bank’s loan approval. Similarly, the Sri Lankan government, as the owner of the project, also handled land acquisition, resettlement and other issues taking place during the railway construction while CMC’s role was to provide technical support.

According to the CMC director, the government and the people of Sri Lanka have high awareness of environmental protection and high requirements for enterprises to follow relevant rules. For example, the Sri Lankan government established Central Environmental Authority, one of which functions is to approve large-scale projects based on the environmental impact assessment conducted by one of its departments.\(^{58}\) The high-handed system imposes high environmental and social requirements on the enterprises. CMC has set up a Department of Environmental Health and Safety (EHS) for the Southern Railway project, responsible to work with the EIA department of the Central Environment Authority and implementing measures proposed in the EIA report, such as cleaning the construction vehicles before driving, stopping construction before 7 p.m. every day to avoid affecting surrounding residents, and conducting monthly sound tests, drainage sample collection and soil collection. In addition, Sri Lanka’s engineering design and construction follows relatively stringent British standards, and the project supervisor is directly employed by the project owner to ensure strict implementation of the engineering standards.\(^{59}\) Therefore with information at hand from the investigation, no obvious problems were found concerning the project’s environmental aspect, and it had caused no further obstacle to the progress of the project.

In fact, compliance with the high standards adopted by Sri Lanka and other similar countries will pose challenges for Chinese enterprises, such as slow progress of the project and consequently higher cost than expected. Apart from the six-month suspension, the delay of the Southern Railway was also caused by the unpreparedness for the strict requirements by the Sri Lankan government. They were beyond the expectation of the CMC whose domestic and overseas experiences seem less than useful in this case. For example, local workers were not able to work on night shift like Chinese workers do, and some parts of the construction were required by local supervisor to be redesigned and rebuilt because they would not recognize Chinese construction standards and experience. While all these requirements led to Chinese enterprises’ time and revenue loss, these are still important


\(^{57}\) Interviews with CMC in field research. 2017.03.26.


\(^{59}\) Interviews with CMC in field research. 2017.03.26.
measures to ensure the quality of the project and control the environmental and social risks. For enterprises and financing institutions, these measures can prevent the project from being questioned, boycotted or even called off.

China Exim Bank and the environmental and social risk management of the project

As required by China Exim Bank and the Sri Lankan government, the environmental impact assessment of the Southern Railway project was the duty of the Sri Lankan government while the enterprise was playing a supporting and supervisory role. The consideration behind China Exim Bank’s requirement that the government is responsible to carry out environmental impact assessment is more with consideration of avoiding environmental and social risks in a form of government warranty. However, in the case of the Southern Railway project, even though the government has taken the responsibility for conducting environmental impact assessment and solving relocation and other related community issues, it did not help mitigate environmental and social risks for the enterprise, but instead put the Chinese enterprise into a passive position. As the enterprise is not the major implementer of the environmental impact assessment, relocation and other issues, it was unable to respond in a timely and professional manner when they were questioned by the public but passively suffered the economic loss caused by the project suspension. Moreover, environmental and social issues may provoke the local community to boycott the enterprise, harm their social reputation, and produce potential negative impact on their future business development in the local context. With the purpose of protecting enterprise’s interests and effectively preventing and controlling risks, it will be more helpful if banks require the environmental impact assessment be conducted by the enterprise itself or a third party, and adopt a higher standard than that of the host country. It will help the enterprise to gain control over the public discourse when questioned or threatened to be called off, and protect its legitimate interests and avoid losses.

On the other hand, China Exim Bank only requires the borrower’s government to complete the environmental impact assessment when providing the “two preferential loans”, but it doesn’t verify or monitor its content and quality, so it is not possible to prevent or control potential environmental and social risks. In terms of organizational structure, China Exim Bank does not have a specialized environmental impact assessment department or personnel like JBIC does to access the EIA work, therefore China Exim Bank is not playing a substantial role in practice. In terms of information disclosure, China Exim Bank does not disclose information about the types of environmental risks or the environmental impact assessment of the loan projects on its official website or any other public platforms, which may cause complaints and distrust among the host country communities and other stakeholders. They may interpret the non-disclosure of information as irresponsibility of the Chinese enterprise and financial institution.

However in terms of engagement of local communities in a project, China Exim Bank played an active role. It requires Class A projects to hold public consultation, requiring projects with potential impact to the community to conduct public negotiation and communication. The involvement of the community stakeholders into environmental impact assessment at an early stage can help alleviate the questioning and resistance from local communities when problems occur, as in the case of the Southern Railway project.
4.3 CASE 2: CHEC AND THE COLOMBO PORT CITY PROJECT (PPP MODEL)

About CHEC

China Harbor Engineering Co., Ltd. (CHEC) was established in the 1980s, and is a subsidiary of China Communications Construction Co., Ltd. (CCCC), one of the world’s top 500 enterprises. It aims at expanding overseas markets on behalf of CCCC. It has more than 70 subsidiaries and offices across the globe, covering more than 80 countries and regions, with a current contract amount exceeding USD 19 billion and employing more than 10,000 people around the world. CHEC is mainly engaged in infrastructure construction including marine engineering, dredging and reclamation, road and bridge building, railway and rail transportation, aviation hubs and related equipment supply and installation. It provides integrated services including contracted construction and investment.60

In 1998, CHEC officially entered the Sri Lankan market by contracting a fishing port project. Since then, CHEC has continued to contract several other framework projects including the tributary port project, the Southern Highway project, and the Hambanatota Port project. In 2011, CHEC established its regional company in Sri Lanka to chase the Colombo Port City project in response to the CHEC headquarter’s proposal to transition and upgrade from engineering company to investment company. On September 17, 2014, Chinese President Xi Jinping visited Sri Lanka, and launched the Port City project together with Sri Lanka’s President Mahinda Rajapaksa. 61

About the project

The Colombo Port City project is a large land reclamation project aiming to build an urban complex integrating finance, business and residence. Adjacent to the central business district of Colombo and the international container port, the Port City is designed to cover an area of more than 5.3 million square meters. The reclamation of 276 acres of land will be completed in three years, the city will take shape in five to eight years, and the construction will be fully completed in 20 to 25 years.62

The Colombo Port City project was jointly developed by CCCC and Sri Lanka Ports Authority. As a wholly-owned subsidy of CCCC, CHEC is committed to expanding overseas markets on behalf of CCCC and constructing the project. CHEC raised USD 1.4 billion in its direct investment for projects, brought USD 13 billion of secondary development investment and creating more than 83,000 jobs. Different from other large-scale projects managed by state-owned enterprises in Sri Lanka, the Colombo Port City is not a project under inter-governmental agreement but is invested and financed in the form of public-private partnership (PPP). CHEC is responsible for investment and financing, planning, construction and operation while the Sri Lankan government is responsible for providing various licenses on environment, planning and construction. 70% of its funds comes from the commercial loan provided by CDB. This project is by far the largest foreign direct investment project in Sri Lanka’s history and one of the most important projects under the Belt and Road Initiative. It is

60 Website of China Harbor Engineering Co., Ltd. 2017.05.05.  

http://cn.apdnews.com/srilanka/quyugongsi/118280.html

62 CHEC and Sri Lanka co-build Colombo Port City: A USD 1.4 billion landfill project.  Guanchacn. 2014.09.16.  
http://www.guancha.cn/Neighbors/2014_09_16_267496.shtml
also one important step in CHEC’s transition effort from an engineering contractor to an investment company.

Suspension crisis

In March 2015, the similar suspension crisis also happened to the Colombo Port City project. The new Sri Lankan government contended that some of the projects endorsed by the previous government had not undergone complete internal procedures and suspended the Colombo Port City project through the Cabinet meeting, requiring CHEC to provide all relevant licenses. The local public opinion mainly focused on the environmental impact assessment of the Port City. According to the CHEC director, the PPP model and the signed contract required the Sri Lankan government to be responsible for the environmental impact assessment and provide the result of the assessment to the enterprise. When the project was suspended, the enterprises had obtained all the EIA licenses, written notice of construction commencement, and other relevant documents.63

According to the contract, CHEC should not bear the consequences of the suspension and the Sri Lankan government also clarified that the responsibility should not lie in CHEC, yet the suspension still created negative impact to the company and the project. The project suffered a one-year suspension, causing a loss of as much as USD 380,000 per day and worsening the livelihoods of more than 5,000 project workers. In fact, more than a thousand workers of the project held rally on March 10, 2015 in protest against the government’s suspension.64

In March 2016, the Sri Lankan government lifted the suspension after a year. In August, the government announced an agreement with the CHEC that the latter had withdrawn its USD 140 million compensation claim, and the government allocated another 2 hectares of land to CHEC in return. Aside from that, the Sri Lankan government also decided to cancel the freehold of the 20 hectares of land by the Chinese side in the previous agreement, and changed the lease period of all the land used by the Chinese side into 99 years. The Sri Lankan government was reported to admit that the new President Maithripala Sirisena suspended the project and changed the perpetuity into a 99-year lease because of the pressure from India and its concern about Sri Lanka’s sovereignty.65

CDB and the environmental and social risk management of the project

The core reasons for the suspension of the Colombo Port City project, similar to that of the Southern Railway project, were a new round of tussle for benefits incurred after the change of Sri Lankan government and its prudence to strike a balance between big powers under the influence of geopolitics. The procedural problem in the environmental impact assessment served as the direct reason for the suspension. The CHEC director in Sri Lanka mentioned that the environmental impact assessment was unquantifiable and the approval of the EIA review did not mean the EIA report was


comprehensive, reasonable and effective. In this case, the environmental and social risks became part of the political risks, and the assessment and prevention of project risks should take both factors into account. Enterprises and financial institutions need to regulate and improve the whole operation process of environmental impact assessment against the possibility of being used as excuses to instigate political crisis, becoming the target of public criticism and leading to other potential risks.

As a contract project, Colombo Port City takes a public-private partnership (PPP) mode. The enterprise and the host country government agreed that the environmental impact assessment shall be conducted by the government. Similar to the EIA in EPC investment, the PPP model can help the enterprise save costs and avoid potential environmental and social risks. In cases of protests or suspension against the EIA, the enterprise will not bear any losses as stipulated in the contract. The CDB, the financing bank of this project, clearly stipulates that the borrower must obtain the EIA document officially approved by the local government before signing the loan contract. The strict requirements of the procedures and documents can serve as evidence for enterprises in face of similar risks.

Attempts to search information and news about the Colombo Port City project show that the CDB disclosed limited information about the project, and the key documents such as feasibility study or environmental impact assessment report were not available on its official website. During our interview, CMC director said that the CDB would regularly conduct post-loan examination and due diligence investigation, however such information cannot be found in any public documents or news records. Therefore it failed to prove to what extent the CDB has played its role of controlling and monitoring environmental and social impacts. Aside from that, the CDB, like China Exim Bank, has not set up any specialized environmental and social department or personnel to keep track on the environmental and social impacts of the project, making it hard to assess and supervise the environmental impacts effectively. That is one of the weaknesses of China’s policy banks in environmental and social policies.

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66 Interviews with CHEC in field research. 2017.03.28

67 Ibid.
5. SYNTHESIZED ANALYSIS AND SUMMARY

By closely examining the environmental and social policies of CDB, China Exim Bank, WB, IFC and JBIC, and comparing the similarities and differences of the environmental and social standards and procedures between China’s policy banks and international financial institutions, the report summarized the strengths and the weaknesses of China’s policy banks’ policies and systems. To better understand the actual role China’s policy banks play in environmental and social risk management of overseas projects, the report dedicated last chapter to introduce and discuss the two cases in Sri Lanka visited and investigated by the GEI team. The Southern Railway project is an EPC contract project financed by China Exim Bank with “Two preferential loans” and the Colombo Port City project is a PPP investment project supported by the CDB. Although financing institutions and project models are different, the two projects encountered similar issues and suffered enormous environmental and social risks against the political backdrop of government change in Sri Lanka.

A cross-check on the policies of the five financial institutions and the two project cases shows that China’s policy banks have standardized and improved document compliance and procedural setting, and some policies are better designed than their international counterparts. However, they still face challenges in environmental and social risk management and need to continuously optimize the environmental and social policies to improve the ability to respond to these risks. It is suggested that more efforts should be made in the following aspects:

**Institutional setting**

Establish specialized environmental and social department to undertake corresponding responsibilities and implement the review, supervision, management and assessment of the project’s environmental and social impacts with clear responsibility and authority. Neither China Exim Bank nor CDB established specialized environmental and social department. The two cases of Sri Lanka’s Southern Railway project and Colombo Port City project underscored the weakness of the organizational structure. The absence of the department makes it difficult for the bank to oversee the unfolding of the EIA and reviewing of its content, coordinate the public consultation and communication with the local community and other stakeholders, help the project to improve the environmental and social impacts, and keep track of subsequent implementation. The bank will also not be able to timely follow the environmental and social risks and take effective preventative measures. Therefore establishing an independent environmental and social department is a measure worth considering for China’s policy bank in order to improve the environmental and social aspects of its work.

**Policy content**

Formulate independent, strict and feasible environmental assessment standards. China Exim Bank and CDB require overseas projects to adopt environmental, social and legal policies of the host country, because the two Chinese policy banks have not set up a set of strict and independent environmental standards of their own, unlike the WB, IFC and JBIC. Even if the host country has high environmental awareness and relatively high standards like Sri Lanka does, and the environmental and social impacts can be controlled to a certain extent by adopting their standards, it is insufficient
to safeguard the project from latent environmental and social risks and it is likely that the project will be questioned and protested by local residents, NGOs and other stakeholders. Because it is the government of the host country who does the environmental impact assessment, the Chinese enterprises have no say when faced with the crisis caused by environmental issues and tend to suffer uncontrollable economic losses. As such, in order to protect the enterprises’ interests, banks may require the project to refer to or adopt the environmental and social standards higher than those of the host country. Investment projects may use the PPP model adopted by Colombo Port City project as an example for reference: while clarifying the responsibility of the host country for environmental assessment, banks and enterprises should also get involved in the supervision of the assessment process and keep record of supervision for possible questionings in the futures.

**Further enrich and refine the environmental and social issues in the policies and formulate specific regulations according to different issues.** China’s policy banks have paid high attention to pollution prevention and control, biodiversity conservation, natural resources management, land acquisition, resettlement and other environmental and social issues, as reflected in their environmental and social policies. However, compared with their international counterparts, these regulations can be further specified and refined. The generalization of the environmental and social issues will restrain the feasibility of the policies and water down their effectiveness. CBD and China Exim Bank can refer to the types of environmental and social issues classified by WB and IFC, adding contents of labour protection, sustainable development of communities, climate change, indigenous peoples, and cultural heritage among others. They can also set up specific regulations and standards for different types of natural resources and pollutions.

**Project procedures**

**Strengthen the pre-loan review of the environmental and social plan and propose suggestions to rectify weaknesses.** It is understood that enterprises’ main interest in a project doesn’t lie in solving environmental and social issues. Not highly motivated nor equipped with the expertise and technologies, they may rely on the financing institutions to improve the environmental and social plans. WB, IFC and JBIC make full use of their professional knowledge to improve the pre-loan environmental and social plans for the clients. For projects with high environmental and social risks, to overcome the weaknesses in the environmental and social plans developed by the enterprise, the banks will try to find an alternative, formulate environmental management plan, or bring forward improvement suggestions and make improvement plans.

The investigation by GEI team shows that China Exim Bank and CDB were not much involved in the environmental assessment and did not control the environmental and social plans given that Sri Lanka’s environmental standards were relatively strict. In other developing countries where environmental standards are not as strict, financial institutions, as the third party independent of the enterprise and the host country government, should play a more significant role in supervision and assistance. China’s policy banks need to provide more professional services to urge the borrower to improve its environmental and social performance in overseas project and reduce environmental and social risks. Apart from the environmental and social requirements imposed on the project in the decision-making process, the banks can also provide professional consultations to push for improvements on the environmental and social plans and set feasible preventative and control measures for risks and impacts.
Pay more attention to field visit in post-loan management and supervision. In the two cases of Sri Lanka’s Southern Railway project and Colombo Port City project, although the CDB and the China Exim Bank established offices in Sri Lanka, the staff members are not responsible for the investigation and supervision of the environmental and social impacts of the project and they rarely intervene in the project operation. Their main sources of information on environmental and social risks are periodical reports. In comparison, the environmental and social policies of the international institutions and JBIC all provide that field visit and investigation should be conducted when necessary. China’s policy banks should learn from this arrangement to strengthen the effectiveness of supervision. Field visit can help the banks to play a more active role in overseas projects and enhance their image of being environmentally and socially responsible. In addition, enlisting third party to conduct investigation and assessment on the environmental and social impacts could be another option.

Mechanism building

Strengthen information disclosure and implement complaint mechanism. Strengthening information disclosure is the trend of reform in international financial institutions, whereas China’s policy banks only made the first step in this endeavor. In the two cases in Sri Lanka, none of the basic information about the project, environmental risk rating and the environmental assessment were made public on the official website of the two banks, and the enterprises were not required to disclose these information on other public platforms either. Missing of project information on public channels tend to escalate public complaints and questionings in the event of suspension crises. Insufficient information disclosure is closely related to the absence of relevant policies. Neither CDB nor China Exim Bank has formulated information disclosure policies or defined the scope and channels of disclosed information. Without hard and fast rules, the CDB even undisclosed its main environmental and social documents. China’s policy banks therefore need to improve the regulations on information disclosure in their environmental and social policies, define the scope and channels for information disclosure, and strengthen information disclosure within the scope of law. Moreover, they can learn from the WB and IFC to bring in complaint mechanism to further ensure that all stakeholders are informed and engaged.

Build a communication and consultation mechanism with the local community. The two Chinese projects in Sri Lanka both suffered some extra resistance from the public, partly due to a lack of transparency of the project and partly due to a lack of communication and interaction with local communities making it difficult to know public attitudes, opinions and latent action towards the project. China’s policy banks need to pay more attention to the communication with the communities affected by the project, establish a consultation mechanism, provide channels to interact and talk with the local community and residents. Communication and consultation can help clear up misunderstanding, mitigate opposition sentiment, and reduce the unnecessary resistance.

In summary, environmental and social risk management is vital for the success of overseas contract and investment projects. To ensure the orderly operation of the project, avoid public questioning and boycott and prevent unnecessary economic losses, banks should strengthen the control of financing process from pre-loan to post-loan, adopt higher and stricter standards, set up professional positions for such job, provide professional resources, and improve information disclosure and consultation with the community. Particularly in the host countries with dim investment prospect, as
many enterprises hope to transform from project contracting to investment, banks should pay more attention to environmental and social risk management to avoid negligence of these aspects which will generate negative impacts on the reputation of Chinese enterprises and China’s overseas image.
6. APPENDIX: KEY DEFINITION AND INTRODUCTION OF POLICY BANKS

Policy bank

A policy bank is a nonprofit financial institution founded or guaranteed by the government to implement the national industrial policies and regional development policies with special financing principles. The development projects supported by policy banks are important to the national economic development and social stability, however, they are usually characterized by large-scale, long lifecycle, slow economic returns and long replenishment so commercial banks are reluctant to finance or incapable of financing these projects.

China’s policy banks were firstly founded in 1994 when The Export-Import Bank (China Exim Bank), the China Development Bank (CDB) and the Agricultural Development Bank (ADBC) were established. The three banks are under direct leadership of the State Council and guided and supervised by the People’s Bank of China. When newly founded, the three banks had clear-cut business orientations: the China Exim Bank mainly supported foreign trade and export of mechanical and electrical products; the CDB mainly supported the national infrastructure construction, basic industry, and pillar industry; the ADBC’s main support went to agricultural development especially in underdeveloped areas, and the production, collection, storage and sales of grain, cotton and edible oil.

However, their business scope has undergone constant adjustments in sync with the changing national policies and economic scenarios. In 1990s China’s national treasury, financially strained, was unable to provide financing and subsidies for the policy banks. The CDB, through bond financing and other self-financing projects, worked out its own “development financing model”, which can be summarized as “serving national strategy, relying on credit support, subsidy-free, market oriented, independent operation, far-sightedness for long-term, low but sustainable profit.” Its business priority areas have shifted from infrastructure, basic industry and pillar industry to urbanization, shantytown rebuilding, and “going out” enterprises. Similarly, China Exim Bank and ADBC also started self-operating businesses. ADBC has expanded its business from collection and storage of agricultural products to all-round support for new rural construction. China Exim Bank’s priority business has been shifted from export of capital goods to providing policy credit and support “going out” enterprises for foreign contracting project and investment.  

Realizing that the policy banks have expanded their financing channels such as bond financing rather than relying on state treasury and opened self-operating businesses and even commercial businesses, the Chinese government placed the reform of policy banks on its agenda in 2007. Then


69 “Self-operating business” refers to self-determined, self-sustaining business at its own risks, but the business still serves the national strategy and policies, so it is different from commercial business.

Chinese Prime Minister Wen Jiabao pointed out at the third financial work meeting that the policy bank reform should follow principle of targeted guidance and “one bank one policy.” The reform aims to redefine the boundary between policy business and commercial business, solve the problems of low capital adequacy ratio and high non-performing loan ratio of China Exim Bank and ADBC, in the hope of the policy banks being self-operating, self-sustaining at their own risks. 71

The reform started with the CDB. In early 2008, the State Council approved China Development Bank Overall Reform Implementation Plan. By the end of the year, the CDB has transformed into a limited liability company, fully implementing commercial operation. It is a different scenario with the China Exim Bank and the ADBC, whose reforms were delayed. In 2009, the People’s Bank of China took the lead in establishing a working team to push forward the reform of China Exim Bank. The team agreed that the bank can open self-operating businesses in addition to its policy businesses but required the bank to manage the two kinds of businesses under separate accounts. It’s hoped that the reform can help the bank supplement capital, strengthen policies and improve governing structure. 72

After being shelved and repeatedly discussed, ADBC’s reform plan was finally approved by the State Council at the end of 2014. March next year, another plan to deepen the reform of the CDB and the implementation plan to reform China Exim Bank were also approved, which marks the finalization of reform plans for all three policy banks. The reform has clearly redefined the business orientation of the three banks: the CDB sticks to development financing institution status while China Exim Bank and ADBC continue to perform policy functions. The reform aims to increase the capital adequacy ratio of the three banks, establish capital constraint mechanism, further improve the organizational and governing structure, improve their asset quality and realize steady and sustainable operation. In July 2015, State Administration of Foreign Exchange injected USD 48 billion and USD 45 million to the China Exim Bank and the CDB respectively, successfully increasing the capital adequacy ratio of the two banks.

**World Bank**

World Bank Group is a multilateral development institution under the UN system, consisting of five development organizations: International Bank for Reconstruction and Development (IBRD), International Development Association (IDA), International Finance Corporation (IFC), Multilateral Investment Guarantee Agency (MIGA) and International Centre for Settlement of Investment Disputes (ICSID). The World Bank Group is different the World Bank which is an international financial institution composed of IBRD and IDA. IBRD and IDA have the same goal, the same staff and the same workplace and they follow the same project assessment standard, but they provide different services and their financing approaches are different.

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IBRD’s capital comes from the paid-in capital contributed by member governments and funds from international capital markets through bond issues. It provides loans, guarantees and risk management products and consultation services to middle-income member country and low-income countries with good credit to improve their economic and social development. In fiscal year 2016, IBRD committed USD 29.7 billion of new loans for 114 projects, covering policy building, energy and mining, transportation, municipal infrastructure construction, industry and trade, finance, health and other social services. The loan balance stood at USD 167.6 billion.

IDA’s capital comes from the contributions from the developed countries and middle-income countries, transfer from the IBRD, the IFC and replenishments from borrower countries. It provides concessional loans, donations and guarantees to poorest member countries. In fiscal year 2016, IDA committed new funds of USD 16.2 billion, including loans of USD14.4 billion, donation of USD 1.3 billion and guarantee of USD 500 million, covering health and other social services, policy building, energy and mining, transportation, agriculture, fishery and forestry and infrastructure construction. The loan balance is USD 132.8 billion.\(^\text{73}\)

The International Finance Corporation (IFC) is funded by 184 member counties and committed to offering a diversity of financing support for the private sectors in the developing countries and the emerging markets, including equity investment, long-term debt investment, fund and structuring financing, to help the developing countries achieve sustainable development. IFC’s business covers more than 100 countries in the world. Its policies were formulated by all member countries. IFC’s main businesses include investment and advisory products. Investment products with longer tenor include: direct lending to private sector companies (including corporate and project finance); lending to various types of financial intermediaries as well as through funds and facilities; minority equity stakes in companies, including in financial institutions; and guarantee facilities, municipal finance, as well as investments managed by IFC’s Asset Management Company or any other IFC subsidiary. Advisory products include technical, financial and/or regulatory advice, project structuring as well as training to companies, industries, and governments.\\(^{74}\)

In fiscal year 2016, IFC made new investment of USD 11.1 billion to 344 projects in 78 countries. Those investments mainly went to financial sector followed by infrastructure construction, agriculture and forestry (graphic 2-5). \(^{75}\) IFC’s strategic priorities include raising awareness of the marginal market, solving issues around climate change, ensuring the sustainability of the

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\(^{74}\) IFC. International Finance Corporation’s Policy on Environmental and Social Sustainability. 2012.1.1.

\(^{75}\) IFC Annual Report 2016 Experience Matters. 
environment and the society, eradicating private sector’s growth constraints in infrastructure, health, education, food supply chain, developing local financial market and building long-term partnership with clients in the emerging market. To achieve the strategic goals, the IFC will pay more attention to the poorest countries and conflict areas and increase investments to agriculture, climate change and infrastructure. In fiscal 2016, 60% of IFC’s consultation services were provided for the poorest countries eligible for applying for IDA loans and USD 1 billion were invested in fragile and conflict areas, a 50% increase over fiscal 2015.

Japan Bank International Cooperation (JBIC) is a policy-based financial institution in Japan, fully owned by the Japanese government. In 1999, former Export-Import Bank of Japan (JEXIM) and Overseas Economic Cooperation Fund (OECF) merged into JBIC. When first established, JBIC’s main business was provide Japan’s official export credit and official development aid. JBIC had two major reforms in 2008 and 2012 as a result of changing Japanese economic landscape and foreign aid policies. In 2008, the Japanese government removed development aid business from JBIC and merged JBIC with The National Life Finance Corporation (NLFC), The Agriculture, Forestry and Fisheries Finance Corporation (AFC) and The Japan Finance Corporation for Small and Medium Enterprise (JASME) into Japan Finance Corporation (JFC). JBIC was mainly responsible for the

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Figure 6-3: Fiscal year 2016 main sectors supported by IFC

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<th>Sector</th>
<th>Percentage</th>
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</thead>
<tbody>
<tr>
<td>Infrastructure</td>
<td>16%</td>
</tr>
<tr>
<td>Information Communication</td>
<td>5%</td>
</tr>
<tr>
<td>Finance</td>
<td>40%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>8%</td>
</tr>
<tr>
<td>Agriculture and forestry</td>
<td>10%</td>
</tr>
<tr>
<td>Customer and social services</td>
<td>9%</td>
</tr>
<tr>
<td>Oil, gas and mining</td>
<td>7%</td>
</tr>
<tr>
<td>Finance</td>
<td>40%</td>
</tr>
</tbody>
</table>

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76 Into of IFC. IFC website.
http://www.ifc.org/wps/wcm/connect/Multilingual_Ext_Content/IFC_External_Corporate_Site/Home_CN.
international financial operations. On 2 May 2011, Japan Bank for International Cooperation Act (JBIC Act) came into effect. JBIC became independent from JFC according to the law.

JBIC’s missions since 2012 has been to contribute to the sound development of Japan and the international economy by promoting the overseas development and securement of resources which are important for Japan, maintaining and improving the international competitiveness of Japanese industries, promoting the overseas business having the purpose of preserving the global environment such as preventing global warming, preventing disruptions to international financial order or taking appropriate measures with respect to damages caused by such disruptions. In fiscal year 2014, 64% of JBIC’s loans, equity participations and guarantee commitment funds have been used to maintain and improve the international competitiveness of Japanese industries, 33% have been used to develop and secure resources and 3% has been used to promote overseas business with the purpose of preserving global environment including preventing global warming.  

As of March 2015, JBIC’s capital amounted to USD 13.51 billion. Outstanding loans and equity participations stood at USD 142.707 billion. Outstanding guarantees reached USD 24.98 billion. It has opened 16 representative offices in Bangkok, Beijing, London, Manila, Mexico City New York, Singapore and other cities. According to the second medium-term business plan drafted in 2012, JBIC will mainly support overseas investment in the areas of energy and natural resource, infrastructure, manufacturing and environment, and mid-tier enterprises and SMEs in their overseas business expansion.

JBIC’s support for Japanese enterprises in overseas investment includes the following facilities: export and import loans, overseas investment loans, united loans, equity participations, bridge loans and guarantees. Since the reform in 2012, JBIC has seen a substantial increase of the ratio of overseas investment loans in its annual total amount of loans, equity participations and guarantees, from 60% in 2011 to 75% in 2012, at the same time, the ratio of the import loans has decreased annually and plummeted to zero in 2014.  


78 JBIC. JBIC Annual Report 2015.