

Zhou Xiaochuan: Supporting the efforts of energy conservation and reduction of pollutant emissions through financial markets

Abstract of an article by Mr Zhou Xiaochuan, Governor of the People's Bank of China, published in Green Leave Magazine.

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Energy Conservation and eco-environment protection were basic conditions for a healthy and sustainable economic development, an important content of promoting harmonious relations between the human beings and the nature and establishing a socialist harmonious society as well as a reflection of the principles of "put the people first" and scientific development approach.

The Communist Party of China (CPC) Central Committee and State Council attached great importance to the work of energy conservation and reduction of pollutant emission by making a series of important policies and arrangements. In May 2007, the State Council issued the *Comprehensive Work Plan for Energy Conservation and Reduction of Pollutant Emission* to stress the importance of the work and focus on relevant policy implementation. In June, the State Council established a leadership group on energy conservation and reduction of pollutant emission, headed by Premier Wen Jiabao. It shows that energy conservation and reduction of pollutant emission has become a top priority for our work.

Financial industry should improve financial services to energy conservation and reduction of pollutant emission and carry out the instructions laid in the videoconference of the State Council. Additionally, financial industry should strengthen awareness of social responsibility and risk prevention, establish effective information mechanism, provide market and policy support to production capacity allocation appropriate with environment endurance, reduce price distortion so that market can play a fundamental role and encourage industrial structural upgrading and a shift of economic growth model through financial market.

I. Highlight financial industry's social responsibility and risk prevention awareness in environment protection, energy conservation and reduction of pollutant emission

In spite of rapid economic growth and magnificent achievements in economic development in recent years, we have paid high costs in terms of resources and environmental degradation, conflicts between economic development and resource and environment have become increasingly poignant and people have strong complaints about environment pollution.

This is directly related with unreasonable economic structure and extensive growth mode. If we don't accelerate economic restructuring, shift economic growth mode, the economic development will be unsustainable. In the *Global Compact*, proposed by Secretary General Mr. Koffi Annan and initiated by the UN in 2000, social responsibilities of enterprises on environment were clearly stressed and enterprises should prepare for environmental challenges and share more responsibilities in regard of environment protection, and encourage application of environment-friendly technologies.

At present, the whole society has reached broad consensus in protecting environment, establishing a harmonious society and realizing sustainable development. The financial industry should fully realize the importance of energy conservation and reduction of pollutant emission and take social responsibilities in environment protection. The financial markets should guide financial institutions to play an active role in the establishment of an energy conservation and environment-friendly society and promote economic restructuring and a shift of economic growth mode.

Commercial financial institutions should establish risk awareness when their clients have problems in environment protection, energy consumption and reduction of pollutant emission. In the first quarter of 2007, industries with high energy consumption and heavy pollution grew relatively fast. Six industries, that is electricity, steel, non-ferrous metal, construction material, oil chemistry and chemistry industries, accounting for 70 percent of the total energy consumption and emission of sulfur dioxide, grew by 20.6 percent, up 6.6 percentage points. The State Council has since required to restrain the relatively fast growth of industries with high energy consumption and heavy pollution. With policy guidance, sound legal system and enhanced supervision, industries and enterprises that cannot meet requirements in environment protection, energy conservation and reduction of pollutant emission will face more stringent policy environment. The financial institutions should establish policy risk awareness and stand vigilant to credit risks from companies with high energy consumption, heavy pollution and high pollutant emission from the point of increasing credit assets' quality.

II. Establish information mechanism that benefits environment protection, energy conservation and reduction of pollutant emission

First, "window guidance" of credit policy should be strengthened. To carry out the ***Comprehensive Work Plan for Energy Conservation and Reduction of Pollutant Emission***, the PBC, relevant supervisory authorities and the China's Associations of Banks should enhance their guidance, and remind financial institutions to consider, when they issue credits, how to effectively control high energy consumption and heavy pollutant industries' excessively rapid growth, accelerate the removal of obsolete production capacities, promote technology advancement in energy conservation and reduction of pollutant emission, assist the development of recycling economy and earnestly enhance the quality of credit assets.

Second, information related to the illegal activities of enterprises in environment protection and pollutant emission should be included in the enterprises' credit registration system. In recent years, the credit registration system has broadened its coverage of information by including enterprises' and individuals credit information and other relevant information and it will include enterprises' environment protection information in the future. The credit registration system will further strengthen its tracking of the key enterprises in energy conservation and reduction of pollutant emission so that it can provide more services to financial institutions and increase their assets quality. Additionally, the credit registration system will allow enterprises and individuals to inquire information from the system and help strengthen law enforcement in environment protection.

III. Financial markets should support the reallocation of production capacity that is commensurate with environment endurance.

In recent years, due to the rapid development of manufacturing industry, some east coastal regions have reached their limits in environment endurance. At the same time, western areas are suffering from under-development and lack of capitals. From the perspective of global experiences, undeveloped countries and regions also extremely need support from international industrial relocation. Accordingly, it is very urgent to promote industrial structure upgrading and reallocation of production capacities according to environment endurance. Of course, in the process, we should avoid repeating the past practice of polluting environment first by addressing environmental problems.

In this process, financial markets and financial policy can provide support through broadening financing channels, improving foreign exchange management, enhancing insurance protection, supporting enterprises to identify and take their relative advantages, providing hybrid loans, syndicate loans, assets securitization, stocks, bonds, project finance and other financial instruments and continuously deepening foreign exchange administration reform for overseas investments.

IV. Reduce price distortion in resource and environment and help market mechanism to properly function.

First, the role of price mechanism should be strengthened. Through price reform in resource products and relaxation of price control, the price distortion in coal, oil products, natural gas, water, electricity, mineral resources will be reduced. Through increasing the collection standard of pollutant emission charges and the relative price effect, heavy pollutant, high energy consumption and emission projects will be constrained while new technologies that meet environment requirements and help energy conservation and reduction of pollutant emission will be promoted.

Second, efforts should be made to learn from the international carbon trading mechanism, explore the implementation of emission quota mechanism and develop the emission quota trading market. Since international investors have increasingly more interests in carbon trade and the establishment of many climate exchanges, carbon trade may become an effective way.

At present, there are three kinds of mechanisms in carbon trading in the world, namely CDM (Clear Development Mechanism), JI (Joint Implementation) and ET (Emission Trading). For instance, in the European Union, according to the reduction plan of greenhouse gas emission, member countries should grant emission license with certain emission quota to relevant companies, and the companies can only emit greenhouse gas within their quotas. If a company wouldn't meet the emission quota requirements, it could purchase extra emission quota from other companies that achieved good performance in greenhouse gas emission, or help developing countries to promote clean energy program as well as exchange for extra "credit quota" through planting trees.

In China, we should learn from the international carbon trading mechanism to study the emission quota system and develop emission quota trading market. Through price-discovery function of the financial markets, different economic entities can adjust their interests and fulfill the target of environment protection, energy conservation and reduction of pollutant emission. The emission quota trading system could also provide a new market-based compensation mechanism for the protective cultivation of farmland.

In summary, financial institutions should fully recognize the importance and urgency of energy conservation and reduction of pollutant emission, take effective measures earnestly to promote the realization of targets set for energy conservation and reduction of pollutant emission in the 11th Five-year plan period as well as a harmonious and sustainable economic and social development.