

# CHINA AS A NEW CLIMATE-RESPONSIBLE DONOR?

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*As the world enters 2019 with the ‚Rulebook‘ adopted at COP24 to operationalise the landmark Paris Agreement, a safe climate future for the world is still far from being secured. Global political turbulence and the continuous rise of populists and climate scepticism still cast a long shadow over international climate actions. China, as an emerging key international donor, is at a crossroads and actively shaping its new role in the global development landscape. Could China become a new climate responsible donor? This policy brief draws the linkage between the development cooperation agenda of China and its impact on the global green transformation towards a safe climate future. It outlines several institutional developments of special attention, namely the Chinese and China-led multilateral development banks as well as its new development cooperation agency. Based on these, avenues towards greener Chinese investments abroad are presented.*

## Background

China is rapidly evolving into one of the world’s largest overseas investors and is now increasingly investing in the renewable energy sector (Tan, X. et al. 2013). China has also enhanced its development cooperation stance through its ever more ambitious south-south cooperation agendas. China’s governance, strategy and policies on overseas investment and development cooperation are undergoing major changes. With the country firmly standing by its commitments to the Paris Agreement on Climate Change, the 2030 Agenda Sustainable Development, as well as its own ecological civilization concept at home, a key question now posed to both Chinese and international decision makers is how China could become a new climate responsible donor.

This brief starts off with highlighting the strong role of fossil fuels in Chinese overseas energy investments and continues by looking more closely at high-carbon projects that are part of the Belt and Road

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**Model of an Integrated Gasification Combined Cycle Power Plant** | © Asian Development Bank/Flickr [CC BY-NC-ND 2.0] [ modified by adelphi, original: 42117-013: Tianjin Integrated Gasification Combined Cycle Power Plant Project in the People's Republic of China]

Initiative (BRI). In order to understand how decisions on external investment strategies are made, it subsequently focuses on the Chinese and China-led development finance institutions, specifically on the establishment of the China International Development Cooperation Agency (CIDCA). Finally, avenues towards greener Chinese investments abroad are presented from a Chinese and a European perspective.

## China's overseas investments portfolio: renewables vs. fossil fuels

Overall, the first-hand information, i.e. from the Chinese government institutions, is far from sufficient to do a primary source portfolio analysis. In most cases, the only information provided is on the type of investment, its location and the type of industry (with a few categories)<sup>1</sup>. The policy banks similarly do not provide sufficient data for analysing the role of green investments in the overall portfolio<sup>2</sup>. We thus have to draw on secondary (academic) literature.

According to the China Global Energy Database at Boston University's Global Development Policy Center<sup>3</sup>, fossil fuel-related projects including extraction, power generation and transmission still account for the vast majority of the Chinese development finance in the energy sector (almost 70% on average during 2013-2016 and 55% in 2017<sup>4</sup>). Chinese policy banks provided \$25.6 billion of energy sector finance to foreign governments in 2017, increasing the total amount of energy finance by China's policy banks since 2000 to roughly \$225.8 billion. In the period from 2013-2017, the majority of energy investments were allocated to the power generation sub-sector. Yet, in 2016, energy-related investments in extraction activities outweighed power generation significantly. Specifically, oil has kept the dominant position among the extraction investments over the years (Jin and Gallagher 2018).

In power generation, over a quarter of investments in 2013-2016 and 2017 was in coal-based capacities. In 2017, the dollar amount of coal financing increased, though the total number of coal projects decreased. Most renewable investments (excluding hydropower) are also allocated in the power sector, but they only account for 7% of total power-related investments in 2013-2016 and for 2% in 2017. Hydropower trumped solar and wind by a large margin, accounting for 38% of power generation investment in 2013-2016. In 2017, investments in hydropower-related projects soared, accounting for 35% of total Chinese energy investment abroad (as opposed to an average of 18% in 2013-2016) (Ibid.).

Regarding the geographical distribution of energy sector development finance, the biggest recipients were developing countries in Latin America and the Caribbean (LAC - 34% of the total over the period of 2013-2016), South Asia (20%) and Europe and Central Asia (19.5%). Despite not ranking in the top three investment regions in the previous years, Africa was the main investment region in 2017 (26.7%), followed by South Asia (22.8%), with LAC at (22.2%) and with investment in Europe and Central Asia (10.6%) falling significantly (Ibid., 2018). At the same time, despite representing a significant proportion of energy sector investment, these regions attract only a small part of renewable energy investments (South Africa, Pakistan and Ethiopia being among the target countries). Most of the renewable power

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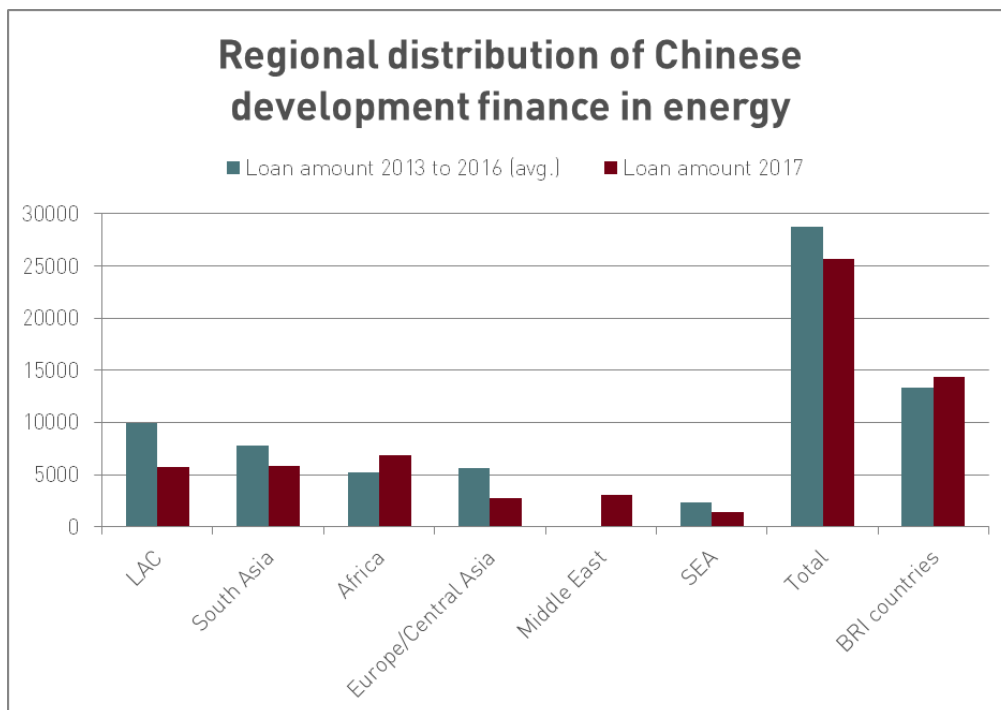
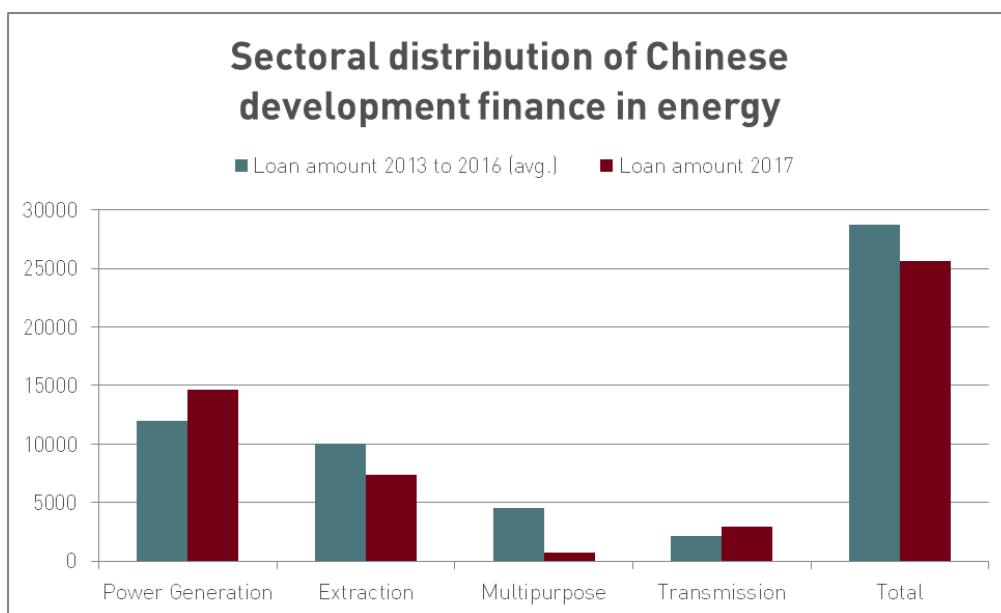
<sup>1</sup> According to the investment project database of the Investment Promotion Agency of Ministry of China (CIPA), there are projects in the renewables sector under the "electricity, heat, gas and water production and supply" industry section where most of the data are aggregated.

<sup>2</sup> We have screened the websites of the Export-Import Bank of China, China Development Bank, ICBC (Industrial and Commercial Bank of China), AIIB (Asian Infrastructure Investment Bank) and New Development Bank, among others. Often, only the aggregate information or general information on their major investments are available, while only some of them provide detailed descriptions of the projects and data on the financing source.

<sup>3</sup> Available online at <https://www.bu.edu/cgef/#/all/Country>

<sup>4</sup> The China Global Energy Database at Boston University's Global Development Policy Center follows a revised methodology for 2017 data, so 2013-2016 averages and 2017 numbers are cited separately.

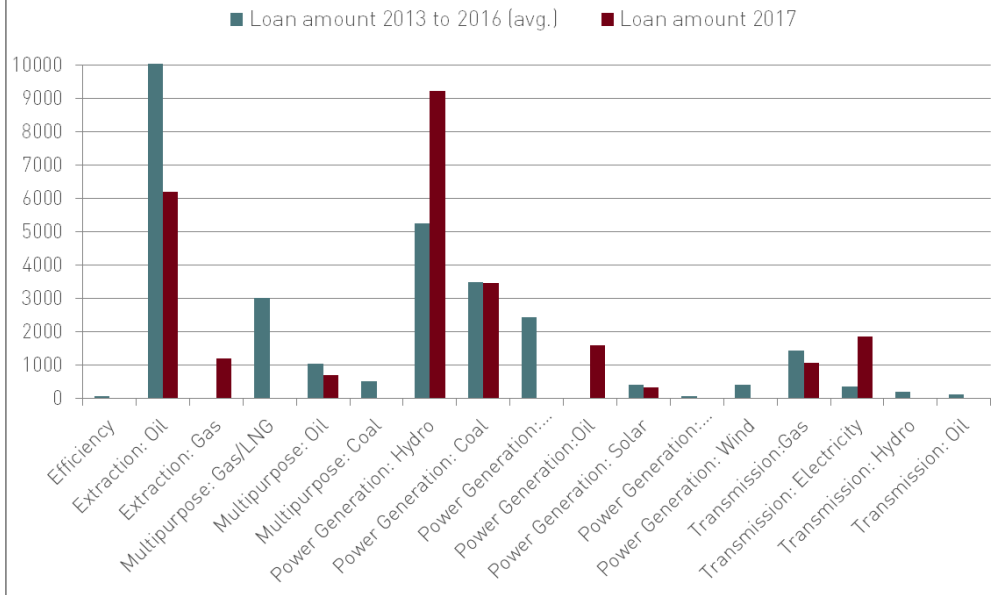
investments were concentrated in a few developed countries (the United States, Germany, Italy and Australia)<sup>5</sup> (Tan. et al., 2013).



Source: adelphi, based on table data from Jin and Gallagher 2018.

<sup>5</sup> The study did not provide the comparison between renewable energy and fossil fuel-based energy investment in this time frame.

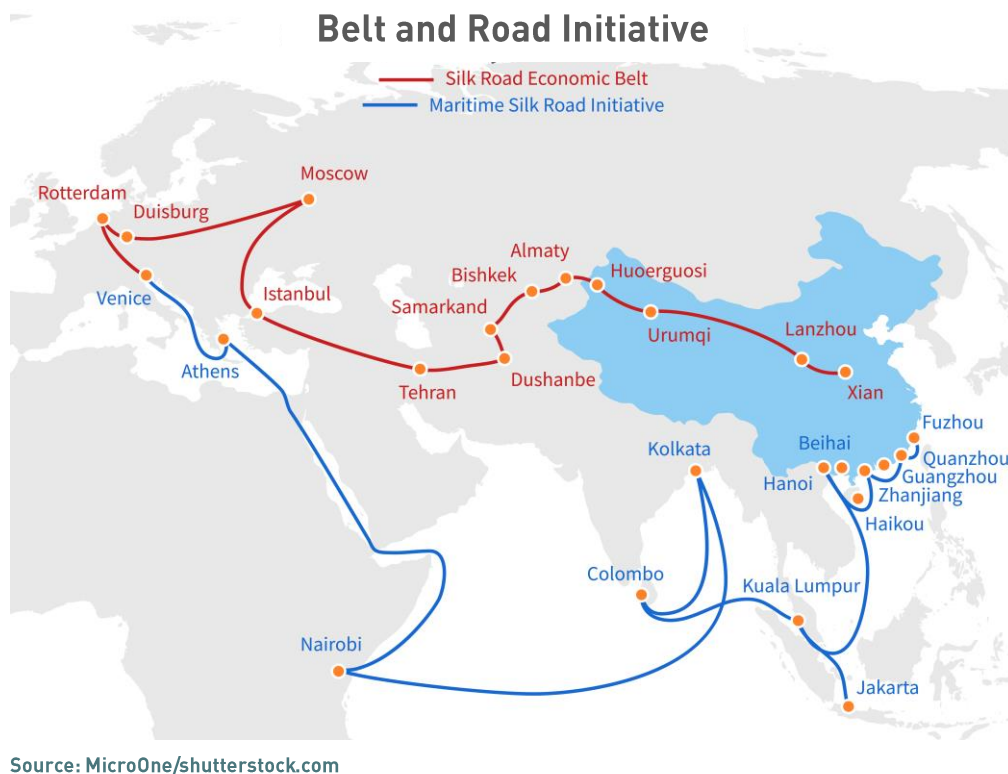
## Detailed sectoral distribution of Chinese development finance in energy



Source: adelphi, based on table data from Jin and Gallagher 2018.

## Belt and Road Initiative: challenges and opportunities

The Belt and Road Initiative (BRI) is the largest international initiative that China has ever put forward, and the country is currently putting all its diplomatic energy into promoting and realising it, backed up by a \$900 billion infrastructure push. The BRI also has raised concerns over its negative environmental impacts as identified by some analysts (such as Ortolani, 2018, Ascensão et al., 2018, Peng et al., 2017, Tracy et al., 2017 and WWF, 2017). Part of this environmental and climate damage is attributed to Chinese companies' economic interest in expanding to markets abroad, as it becomes increasingly difficult for them to stay profitable in the Chinese domestic market that can no longer absorb all production capacities (Tracy et al., 2017). Construction of coal-fired power plants is one such example.



Since 2001, Chinese development of coal-fired power projects in countries targeted by the Belt and Road Initiative has been significant (though it must be noted that the Initiative was officially announced and coined by Xi Jinping during a speech at the Nazarbayev University in Astana in 2013). By the end of 2016, China had been involved in 240 coal-fired power projects in 25 of the 65 countries along the Belt and Road, with South Asia and Southeast Asia as the main project locations. 52 of these projects are in the pipeline (planned or signed projects) with a capacity of 72,116 MW, accounting for 12.7% of coal plants in the pipeline globally. 114 projects are in operation with a capacity of 88,018 MW, accounting for 4.5% of global coal capacity (Peng et al., 2017). Some even argue that China has filled the gap in financing coal plant projects, a gap stemming from the European Investment Bank (EIB) and World Bank's decision to no longer finance coal plants (Ibid.). However, the numbers have fluctuated: a period of rapid development from 2001 to 2010 was followed by lower annual capacity additions from 2011 to 2013. From 2013 to 2015 there was an upward trend; yet, in 2016 capacity additions were lower than in 2015 again, which "can be seen as in line with the consensus of the 2015 Paris Agreement" (Ibid.).

There is some high level rhetoric in conjunction with promoting a 'Green' BRI. For example, President Xi Jinping's speech at the BRI Forum in May 2017 committed China and its partners to an environmentally-friendly BRI in accordance with the 2030 SDGs. The "Guidance to Promote the Construction of a Green Belt and Road" was released in the same month. But analysis of existing BRI documents and speeches shows very little consideration for a strategic environmental assessment or an environmental impact assessment (Tracy et al., 2017).

In fact, if directed to sustainable projects, BRI investment may help tackle some of the central structural challenges in their target countries. According to a 2015 McKinsey & Company report (Li, 2015), countries and regions along BRI (including EU member states) have a population of nearly 5 billion people, and a total economic output of about 39 trillion USD, comprising 70% and 52% of global totals respectively. Infrastructure in these regions is generally outdated, and it is estimated that the annual infrastructure investment needs exceed \$1.5 trillion. These economies are also very resource-intensive: BRI countries consume more energy, non-ferrous metals and water as well as more steel and cement per unit of GDP than the world average. Their respective carbon dioxide emissions per unit of GDP are about twice the world average and growing rapidly. The air pollution in their large cities is significant (Li, 2015). Given the pressing need for and the danger of a carbon lock-in through infrastructure development, China should aim to be a climate-responsible, sustainable donor and focus on cooperating with BRI countries on advanced production capacity and low-carbon infrastructure projects. This could include sustainable (efficient and low-carbon) energy systems, low-carbon urban mobility or resource-efficient, knowledge-intensive industries.

## China and its new MDBs

To directly or indirectly support the BRI and enhance its role in the global development finance landscape, China has helped to establish and fund two multilateral development banks (MDBs) since 2015. The Asian Infrastructure Investment Bank (AIIB) is headed by China, which now has an approved membership tally totalling 86 (Gutner 2018)<sup>6</sup>. The New Development Bank (NDB), headquartered in Shanghai, is a joint and equal operation between the BRICS nations (Brazil, Russia, India, China and South Africa). Given that the AIIB will provide a large share of financing for China's new ambitious overseas projects (with \$100 billion in capital), it can play a key role in pushing for effective environmental standards among all parties applying for these funds (Tracy et al., 2017).

When comparing the AIIB to other big development banks, it seems to be falling short on Ecological and Social Guidelines (ESG), which are meant to prime its activities for a socially and environmentally-responsible approach to infrastructure development. The lack of ESG is likely resultant from the stance of the Chinese Government on the economic design of such developments, both from a fiscal and cultural perspective (Radavoi and Bian, 2018). This means that there is still plenty of space for improvement regarding the formation and implementation of the social and environmental standards of AIIB. At the same time, the lack of environmental and social standards or inclusion of local communities in some projects has caused reputational as well financial damages (Ortolani, 2018). For example, in Sri Lanka, the construction of a Port City in Colombo (by claiming land from the Indian Ocean) was stopped by the Sri Lankan government (Safi, 2018). Thus, regular environmental assessments of project impacts, creating feedback possibilities for actors affected by projects, or restraining support to emission-intensive sectors such as coal power plants can be promising measures for the China-led MDBs to improve their sustainability performance (Soutar, 2018).

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<sup>6</sup> That compares with 189 at the World Bank's International Bank for Reconstruction and Development, and sixty-seven at the Asian Development Bank.

## New development cooperation agency to consolidate China's foreign aid agendas

In March 2018, the Chinese government announced a new institutional reform to restructure the State Council. In this plan, a new agency, the China International Development Cooperation Agency (CIDCA), was mandated to be set up alongside the establishment of several new ministries including two mega ministries in charge of environmental protection and resource management. This is aimed at changing the previous aid structure, which was understaffed and fragmented, and to form an efficient and foreign aid-capable top-level design, supervision and evaluation agency.

Until earlier this year, the Ministry of Commerce (MOFCOM) and the National Development and Reform Commission (NDRC) were the main government departments in charge of China's overseas investments. Other government departments and agencies that develop policies associated with overseas investments are the Ministry of Foreign Affairs, State Administration of Foreign Exchange, State Administration of Taxation and China Export & Credit Insurance Corporation (Zhu, n.d.). Finally, China's state-owned policy banks, largely the Export-Import Bank of China and the China Development Bank, play a leading role. They facilitate international capital flows and support mergers and acquisitions of foreign companies.

### Evolvement of China's development cooperation governance in the past decades

Development cooperation has served the national interest and foreign strategy of China in different contexts across time. China's development cooperation is of urgent need to adapt to and support the new strategy of 'great power' diplomacy set up by Xi. From the founding of the People's Republic of China in 1949 up to 2017, three phases of the country's development cooperation (CAS, 2017) can be identified:

- Driven mainly by the ideology of communism and hence supporting other communist countries, 1950-1960 saw the founding of Ministry of Foreign Trade (MFT) as a major ministry responsible for China's development cooperation (in 1952). The Technical Cooperation Bureau, the Complete Sets of Equipment Bureau and the Foreign Economic Relations Department were later set up under MFT for implementation and execution purposes.
- 1960-1982 saw the quick build-up of development cooperation in China, where at its peak development accounted for 7.2% of the total financial budget in 1973; a specialised agency directly under the State Council, the Foreign Economic Relations Bureau, was first set up in 1960 (it later became the Foreign Economic Relations Commission (1964) and then the Foreign Economic Relations Ministry (1970)) and then diminished and merged with other peer institutions into a new Ministry of Foreign Trade.
- 1982 till 2017 saw two major changes of the institution, i.e. in 1993 the ministry was renamed as Ministry of Foreign Trade and Economic Cooperation and in 2003 further renamed as the Ministry of Commerce (MOFCOM). In this period, the scale and intensity also increased gradually.

The official mandates of the CIDCA include making strategic guidelines, plans and policies on foreign aid; coordinating and making suggestions on major issues related to it; driving aid provision reform; and making foreign aid plans and overseeing and evaluating their implementation. Meanwhile, the

implementation of development cooperation projects is still left to MOFCOM and other relevant ministries.

The CIDCA also has a specific focus on development cooperation projects around the BRI as well as on projects that are aligned with the initiative, such as the overall BRI-implementation strategy and specific country plans. This is also reflected by the appointed leadership of the CIDCA. Its director Wang Xiaotao, had focused on international development cooperation with BRI countries in his previous position at NDRC. After his appointment, he stated that the CIDCA will give China more room to pilot new, innovative approaches to development cooperation. It is clear that the founding of the CIDCA is within the overall 'Major State Diplomacy' (Da Guo Wai Jiao) strategy that the Xi administration has been advocating for development cooperation as a tactic to maximise China's national interests as well as further improve its international standing and reputation.



## Avenues for action from a Chinese perspective

**Enhancing green investments overseas would provide strong support to China's overall foreign policy goals.** The CIDCA offers a new opportunity for integrating China's domestic experience and know-how in environmental protection, low carbon development and green finance into its broader foreign aid strategy<sup>7</sup>. Another benefit stems from the support that such a foreign aid strategy could provide to the 'great power' foreign policy. By developing an overarching green investment strategy, the CIDCA would help to build the image of China as a responsible global player. Finally, China also seeks to increase its soft power, by promoting its philosophy and concepts such as the ecological civilization. This effort would be greatly supported by enhancing green investments and contributing to the low carbon transition of other countries.

**China would benefit from boosting green investments in BRI countries.** Energy-intensive industries are one of the top cooperation priorities within the BRI. China should make good use of its relative advantage – in comparison with many BRI countries – in energy conservation, environmental protection and carbon emissions reduction by promoting cooperation and the development of technologically-advanced and green production capacity in resource-intensive economies. Moreover, it could help build up a broad coalition supportive of the international climate change (Paris Agreement) and sustainable development (Agenda 2030) regimes, which China is already firmly standing behind. China is experiencing ever growing pressure when it comes to the global climate regime, and such leadership signals would also help to counterbalance the surge in expectation.

**Promoting high standards and best practices in multilateral finance, China can foster trust and improve its international standing.** China can use the MDBs where they play a critical role (i.e. AIIB and NDB) for replication of best practices regarding transparency and standards for social and environmental protection and risk management. The creation of these new institutions partly reflects China and its emerging economy peers' growing dissatisfaction with the existing global multilateral financial frameworks where they are underrepresented. More importantly, they also reflect China's greater ambition in being part of international governance and shaping the new international order. This inevitably creates some suspicion or even potential conflicts with existing 'Western' powers like the United States and China's neighbouring countries like Japan. Enhancing transparency and adhering to international best practices, including the implementation of high standards for social and environmental impact assessments, consultation with impacted communities, and making good-faith efforts to address negative impacts, would help to win broader support not only in the recipient countries but also among potential sceptics or competitors. By replicating international common standards and best practices, China would also make its statement that the new MDBs are designed to complement existing financial architecture (rather than necessitating a complete overhaul) more convincing.

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<sup>7</sup> One concrete example could be to draw on existing domestic pollution control, clean production, advanced capacity, resource and energy conservation, and environmental protection-related guidelines and catalogues (including positive and negative lists) to develop green cooperation guidelines for key sectors. A similar case could be made for banning the overseas projects that fall under the category of outdated capacities that is already applied to domestic industries.

## Avenues for action from a European perspective

**Understanding geopolitical, environmental and social implications of Chinese support abroad is needed to pursue European international priorities.** Chinese development finance is often scrutinised in depth as a possible means to gain economic and political influence, but it will also contribute to tipping the global climate scales: much of it is directed to infrastructure that could lock-in carbon-intensive economies or promote a low-carbon transition. In the 2018 Leaders' Statement on Climate Change and Energy, the EU and China "emphasize the global vision to make financial flows consistent with a pathway towards low greenhouse gas emission and climate-resilient development." In the light of this, European actors (i.e. of the EU and of its Member States) need to look more systematically at the potential of Chinese investments abroad – and specifically thinking of the BRI – to shape development pathways of the target countries and regions, and also emphasise this dimension when discussing the BRI with China, with third parties and at home.

**European actors should analyse possible impacts of China-supported projects on achieving the goals of the Paris Agreement in a set of BRI countries and promote climate-compatible options.** European decision makers should step up regional expertise and activate European foreign policy capacities in the BRI target countries to understand the respective country context and help build support for low-carbon investments. This should also include efforts to better grasp the heterogeneous Chinese interests behind the investments in different regional contexts. European foreign policy should therefore use the full range of diplomatic instruments to advocate for the benefits of a green BRI in and outside China. This should be accompanied by supporting the actors in China with an interest in the ecological civilization paradigm, e.g. by facilitating dialogue between groups and through the exchange of best practices. What could also help in this endeavour would be to increase the exchange of perspectives and knowledge between actors from the diplomatic, environmental and development spheres (e.g. the Sino-German Centre for Sustainable Development, Sino-German Climate Change Working Group), further bridging and connecting their networks in order to promote greener BRI initiatives.

**Engaging with the CIDCA – as a key agent of Chinese external aid strategy – can promote successful European sustainable energy and climate agendas.** The future set-up of Chinese international aid and investments is still in flux. China could become a new climate responsible donor with a major positive impact. European decision makers should take every chance to catalyse and enable Chinese support to global agendas such as the Paris Agreement through the country's overseas finance. Integrating Chinese development cooperation and the broader dialogue on energy and climate diplomacy policy would substantially benefit these efforts to increase the proportion of green investment. The CIDCA is an important stakeholder for bilateral and multilateral exchange with China due to its potential for influencing crucial financial decisions. While MOFCOM (which is still in charge, together with other relevant ministries, of the implementation of development cooperation) will by no means become less relevant as a dialogue counterpart, the CIDCA is likely to develop into a crucial node in the Chinese external action networks as well, among others, due to its strategic tasks as rule maker and its focus on the BRI. This offers a good opportunity to discuss aligning aid investment flows with Paris targets and SDGs.

**European decision makers should cooperate with China to tackle barriers to implementation of best transparency, environmental and social practices in the multilateral finance landscape.** High-level and diplomatic support to dialogue and coordination among the MDBs on greening financial flows can be highly beneficial for global sustainability agendas. European actors should plausibly highlight the advantages of and drive towards more transparent, effective and coherent international aid. The EIB has been advancing in the field: following a high-level agreement with the Chinese Ministry of Finance in 2016, the bank has been channelling low-carbon investment to China's energy, transportation and forestry sectors. The China Green Finance Committee and EIB issued a joint White Paper on green bond standards. Furthermore, EIB and AIIB cooperation holds great potential to cooperate on strategic

infrastructure, and could concentrate on low-carbon development in the future (China Daily 2017). The EIB and European external action should seek to capitalise on these experiences in order to work with Chinese-led MDBs on environmental and social practices in investments outside China as well as on promoting high-standard green finance internationally. Involving Chinese foreign aid-related government bodies in a dialogue can not only support low-carbon development, but also help build trust among major aid donors and have positive spill-overs on international relations.

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