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Sustainable Finance and Green BRI Practice in Africa and South Asia: A Response to the Changing International Political Order

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Key Points:

- In response to criticism in the Western world, China is building a more friendly national image by supporting sustainability within BRI projects.
- Sustainable finance for BRI projects is mainly supplied by the large Chinese commercial banks.
- The latest practice of 'green' BRI in Africa and South Asia has successfully realized Beijing's hope of re-building its national image within the changing international political order.
- In the era of COVID-19, there will be more opportunities for China to expand its impact within the international political order by leading sustainable finance and green investment in the global economy.

Introduction

China's Belt and Road Initiative (BRI) represents one of the most significant frameworks for foreign capital investment around the world. Many scholars have pointed out that the BRI is based primarily on China's economic and geopolitical strategies;[1] therefore, how China's BRI policy changes, or will change, the traditional financial regulatory pattern of international investment for China is an interesting and pertinent issue for discussion.

Chinese infrastructure investment in BRI host countries has been widely criticized by Western countries in recent years. This criticism is largely driven by developed countries' concern over national, industrial and socio-economic problems which may be intensified by Chinese firms under the ambitious BRI policy. In addition, the rapid emergence of Chinese power in high-tech areas such as artificial intelligence, and the state capitalistic power in exporting infrastructure

[1] Emilios Avgouleas & Vasilis Trigkas, *Alleviating the Thucydides' Trap through Welfare State Dependence: How the Funding Needs of the Western Welfare State Can Influence Multilateral Relations with China*, 11 GLOBAL POLICY (2019); HINRICH VOSS, THE DETERMINANTS OF CHINESE OUTWARD DIRECT INVESTMENT (2011) 73-76.

construction exacerbate the already strained relationship between China and many developed countries. Beijing's latest high-profile practices in promoting green finance and sustainable investments in Africa and South Asia should be understood as a response to the above criticism and aimed at enhancing the economic impact of China in developing countries.

PRC Commercial Banks as Active Players in Supporting Sustainable BRI

As most BRI investment projects are sponsored by debt finance, particularly the banking loans from Chinese state-owned commercial banks, therefore in a practical context, green financing of BRI projects is primarily supported and developed by those large commercial banking groups and policy banks of China.[2] The state-owned banks financing BRI projects are the key players who essentially implement green finance policies of China.[3]

Since the launch of the BRI in 2013, the Export-Import Bank of China has provided targeted and adaptable policy-based green financial services for enterprises to carry out international economic and trade cooperation, transformation and development, use financial tools such as loans, investment, and consulting, and to support Chinese enterprises in implementing green financial projects at home and abroad. In key areas for business development in Asia, Africa, Europe and Latin America, the Export-Import Bank of China has not only put environmental protection at the heart of a number of infrastructure projects it has promoted, it has also supported the construction of 'green and clean' projects. New energy and utility projects have played a demonstrative and leading role in promoting Chinese green enterprises to "go global" and the development of a green economy along the BRI.[4]

By the end of 2018, for instance, the balance of loans for energy conservation and environmental protection projects and services by the Export-Import Bank of China exceeded RMB 250 billion.[5] By supporting Pakistan's Kalote Hydropower Project, Ethiopia's Adama Wind Power Project, Kenya's Mombasa-Nairobi Railway Project, Malaysia's Penang Solar Cell and Solar Module Production Line Project, and France's CMA CGM 9 ultra-large container projects, the Export-Import Bank of China is actively promoting sustainable practices within the BRI.[6] While developing the green economy along the route, it has also played a role in demonstration and guidance.[7]

The Industrial and Commercial Bank of China (ICBC) initiated the establishment of the "Belt and Road" Bank Roundtable in 2017 and, two years later, it jointly issued the Belt and Road Green Finance Index (BRI Index) to help evaluate the environmental impact of investments along the

[2] Muyang Chen, *Beyond Donation: China's Policy Banks and the Reshaping of Development Finance*, 55 (4) ST COMP. INT. DEV. (2020) 436.

[3] *See* SIMON ZADEK ET AL., SUSTAINABILITY IMPACTS OF CHINESE OUTWARD DIRECT INVESTMENT: A REVIEW OF THE LITERATURE, IISD REPORT (2016); SCOTT VAUGHAN ET AL., GREENING CHINA'S FINANCIAL SYSTEM, IISD REPORT (2015); Hao Chen & Meg Rithmire, *The Rise of the Investor State: State Capital in the Chinese Economy* 55 (3) ST. COMP. INT. DEV. (2020) 257.

[4] *See* Johanna Coenen et al., *Environmental Governance of China's Belt and Road Initiative*, 31(1) Environmental Policy and Governance (2020).

[5] Xu Sheng, *The Export-Import Bank's "Belt and Road" green credit balance has exceeded 250 billion yuan*, XINHUA FINANCE (Apr. 24, 2019), http://greenfinance.xinhua08.com/a/20190424/1821450.shtml.

[6] *See* Chen, *supra* note 2; CHRISTOPH NEDOPIL WANG, CHINA'S INVESTMENTS IN THE BELT AND ROAD INITIATIVE (BRI) IN 2020, INTERNATIONAL INSTITUTE OF GREEN FINANCE (Jan. 2021).

[7] Xu Sheng, *supra* note 5.

BRI route.[8] The BRI Index takes 79 countries along the route as its focus, and selects 17 key indicators to generate an index which measures the performance of the green economy (environmental efficiency, environmental governance, etc.) and green development capabilities (financing capabilities, policy and technical support capabilities) in individual countries. It can also help policy makers and investors in various countries quantitatively analyze the investment potential of the BRI green investment opportunities and environmental challenges, and guide the flow of capital to green initiatives.[9]

Following the ICBC, the Bank of China has issued seven green bonds overseas since 2016, with a total value of approximately US$8.3 billion. The funds raised will be utilized to support, for example, clean energy, clean transportation, resource conservation and recycling, pollution prevention, and climate change responses. The Bank is also exploring the provision of low-cost, long-term and stable funding for overseas green projects.[10]

Sustainable Finance Promotes Green Transitions in BRI Countries

Ever since the issuance of Green Investment Principles for the BRI[11] in 2018, both China and BRI countries are taking action and enhancing their collaboration to accelerate the phase-out of domestic coal investments in BRI countries. Some key BRI countries such as Pakistan have developed their own specific policies and legislation which aim to reduce consumption of fossil fuel. China, as one of their trustworthy economic cooperators and finance suppliers, is playing an active role in accelerating this transition by means of enhancing the supervision and screening of energy finance projects.[12] For instance, the Government of Pakistan announced that the country will not approve any more coal-fired power plants after 2021.[13] Although a number of Pakistan's coal-fired plants are financed and built by Chinese corporations via the China-Pakistan Economic Corridor framework, the new domestic policy against coal-fired plants should provide more opportunities for encouraging green investment and financing in renewable energy projects in

[8] *The ICBC Issued the BRI Green Finance Index,* BAIDU (Apr. 26, 2019), https://baijiahao.baidu.com/s?id=1631864391472108869&wfr=spider&for=pc; *ICBC Drives Green Growth with Nearly RMB 1,000 Billion Financing,* ICBC NEWS (June 29, 2017), http://www.icbc.com.cn/ICBC/EN/NewsUpdates/ICBCNEWS/icbcdrivesgreengrowthwithnearly1000billionfinancing.htm; ICBC, *ICBC Arranges Financing for the Largest Power Plant Project in Eastern Africa*, ICBC NEWS (July 3, 2015), http://www.icbc.com.cn/ICBC/EN/NewsUpdates/ICBC NEWS/icbc arranges financing for the largest power plant project in eastern africa.htm.

[10] *Bank of China has Issued US$8.3 billion Overseas Green Bonds*, BAIDU (Oct. 16, 2020), https://baijiahao.baidu.com/s?id=1680692675732516012&wfr=spider&for=pc.

[11] The Green Investment Principle (GIP) was first published in London in November 2018. The GIP is a set of principles for greening investment in the BRI which was co-initiated by the Green Finance Committee of China Society for Finance and Banking and the City of London Corporation's Green Finance Initiative. Basically speaking, the GIP encourages (but does not mandate) all investors involved in BRI projects to comply with the following principles: 1) Embedding sustainability into corporate governance; 2) Understanding environmental, social and governance risks; 3) Disclosing environmental information; 4) Enhancing communication with stakeholders; 5) Utilizing green financial instruments; 6) Adopting green supply chain management; 7) Building capacity through collective action.

[12] Particularly, on Sept. 21, 2021, Chinese President Xi Jinping announced at the UN General Assembly that China "will not build new coal-fired power projects abroad", THE GUARDIAN (Sept. 22, 2021), https://www.theguardian.com/world/2021/sep/22/china-climate-no-new-coal-fired-power-projects-abroad-xi-jinping.

[13] Jingying Han & Christoph Nedopil Wang, *China's coal investments phase-out in BRI countries – Bangladesh case*, GREEN FINANCE AND DEVELOPMENT CENTER (Apr. 27, 2021), https://green-bri.org/chinas-coal-investments-phase-out-in-bri-countries-bangladesh-case/.

Pakistan. Similarly, Egypt, another BRI country, postponed the construction of the Hamrawein coal-fired power plant in March 2020 because the government recognized that the power generation capacity in Egypt is sufficient, and anticipate that their energy markets will be transformed from fossil fuel towards renewable energy in future.[14] The above examples in two BRI countries indicate a move to more sustainable energy production in BRI countries in the future.

As a response to the above changes in energy production, it can be expected that Chinese financial institutions will be incentivized to implement the Chinese government's guidance to limit or end fossil fuel financing (partly due to the stranded asset risks) and to give favorable lending terms to host countries for renewable energy projects. For example, in February 2021, the Chinese embassy in Bangladesh announced that Chinese financial institutions will no longer consider any investment projects causing high pollution, such as coal-fired power plants, or with high energy consumption. However, it should be noted that a variety of coal-fired power plant projects valued at US$24 billion were included in a memorandum of understanding signed by China and Bangladesh in 2016. In early 2021, the Bangladesh government mandated the replacement of five of the above coal power plants projects with plants using sustainable energy sources. In response to Bangladesh's exclusion of these coal investments, Chinese financial institutions now require that new BRI projects recommended by Bangladesh should meet high levels of green finance and implement environmental protection plans[15], otherwise the Chinese banks will not provide loan to support the projects.

Bangladesh and Pakistan are just two examples illustrating how Chinese financial institutions and the Chinese government are actively cooperating with BRI countries to accelerate the green energy transition. In fact, based on the green finance and responsible investments initiated by Chinese enterprises and government, coal investments have steadily declined from their peak in 2015.[16]

Accelerating the Green Transition of BRI Investment in the Era of Pandemic

Chinese overseas investment in BRI countries fell to US$47 billion in 2020, 54% less than in 2019.[17] In the context of global cross-border investment, these BRI investments have declined faster than global foreign direct investment (FDI) flows, and the investments in BRI countries are expected to decline by 16% during the first half of 2020 compared with investment in 2019.[18] During 2020, the BRI countries that received the highest levels of Chinese investment were Vietnam, Indonesia, Pakistan and Chile, although most BRI projects were impacted by the pandemic. However, several countries saw an increase in Chinese investment despite COVID-19, including Thailand, Poland, Bulgaria and Zambia.[19] In terms of green investment in BRI projects, it is noteworthy that the proportion of renewable energy investments (e.g. solar, wind, hydropower plants) increased

[14] Shilin Zhao et al., *Migration and Emission Characteristics of Trace Elements in a 660 MW Coal-Fired Power Plant of China*, 30 (7) ENERGY & FUELS (2016) 5937.

[15] For example, the new BRI projects in Bangladesh which will be backed by Chinese financial institutions should 1) Apply the Green Development Guidance for BRI projects; 2) be supported by the government's policies that favor renewable energy investments, etc.

[16] NEDOPIL WANG, *supra* note 6.

[17] *Id.*

[18] *Id.*

[19] *Id.*

from 38% in 2019 to 57% in 2020[20], which constituted the majority of Chinese overseas energy investments in BRI regions.[21] Despite uncertainties associated with COVID-19 globally, Chinese energy investment in BRI countries is likely to continue the transition from supporting fossil fuel projects to more environmentally friendly investments.[22]

In the first place, both Chinese and international investors may prefer smaller projects that are easier to finance and are faster to complete. Therefore, the traditional coal-fired power plants will not be a good choice for BRI investors in terms of profitability, given the need for long-term loans and the increasing political risk of disapproval by the local authorities. Secondly, the operation of coal-investment depends on a stable and efficient supply chain; however, the lockdown and uncertain restrictions on travel and transportation during COVID-19 bring higher risks to the profitability of coal-investment in the near future. As a result, BRI investors may be incentivized to support renewable energy projects to secure their own economic interest. Thirdly, local authorities in BRI host counties will also be motivated to accept more small-scale and time-efficient renewable energy projects to avoid, or at least mitigate, reputational, social and environmental risks arising from the shut-down or cancellation of unfinished projects due to economic difficulties during COVID-19.

In 2020, BRI energy investments were around US$20 billion in total, with Pakistan, Russia and Indonesia received the greatest investment.[23] The proportion of hydropower investments (35%) has, for the first time, surpassed that percentage from coal-fired plants (27%). At the same time, the investment in solar power plants increased steadily, and is expected to surpass support for coal-fired power plants in 2021.[24] Moreover, it is promising to observe that several BRI countries have received 100% green energy investments from Chinese enterprises, including Qatar, Oman and Egypt.[25]

It can be expected that the highly uncertain impact of the pandemic will increase risks associated with FDIs, including in BRI investments. The long-term lock-downs have exacerbated economic plight, which is particularly serious in developing countries. Therefore, the investment strategies of Chinese enterprises, including financial institutions, needs to change. This change could be a potential opportunity to further promote green finance in BRI projects.

Overall, although the COVID-19 pandemic has seriously affected the global economy including in BRI regions, in terms of green finance and sustainable investment, however, some unexpected opportunities are arising. Thus, it will be very interesting to see how and to what extent green finance will be able to promote energy transitions in BRI countries in future years.

[20] In fact, the representation of renewable energy investment has increased from no more than 20% in 2014 to more than 50% in 2020.

[21] NEDOPIL WANG, *supra* note 6.

[22] *Id.*

[23] *Id.*

[24] *Id.*

[25] In Egypt, the government postponed the construction of a US$4.4 billion, 6 GW coal-fired power plant at the beginning of 2020 which increased the sustainability of BRI investment in the country. *See* Mohamed Farag, *Egypt postpones $4.4 billion, 6GW coal plant, pushes renewables instead*, INSTITUTE FOR ENERGY ECONOMICS AND FINANCIAL ANALYSIS (Apr. 7, 2020), https://ieefa.org/egypt-postpones-4-4-billion-6gw-coal-plant-pushes-renewables-instead/.

Conclusion

Although Beijing's ambition in establishing its leadership in developing countries via the BRI is regarded by Western countries as a threat to the old international political and economic order, I conclude that the high-profile practice of green finance and sustainable investment in BRI projects during recent years is one of China's responses to the changing international political order. The Chinese state-owned financial institutions are now playing a very active role in not only financing sustainable projects in BRI countries but also supporting the green transition of the domestic economy of those countries. It is obvious that sustainable finance and responsible investment in BRI is an essential part of Beijing's evolving political strategy aimed at improving its national image in the current international order. Finally, Beijing's ambition in leading sustainable finance will also generate commercial benefit for Chinese firms, as efficient green investment, particularly in the energy sector along BRI countries, is an emerging commercial opportunity for Chinese enterprises. Last but not least, although China has expressed its ambition in green finance and carbon emission reduction, the conflicts between the lack of green energy and the demands of economic development may still increase uncertainties in relation to the development of green finance. This may be particularly true for those investment and financing activities overseas. Therefore, it is a noteworthy to see how China solves the problem of decarbonizing energy supply in its own market and at the same time, what role China will play in the global green finance market.

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