E3G

MAPPING THE POLITICAL ECONOMY OF THE CHINESE FINANCIAL ECOSYSTEM

AUGUST 2021

CONTENTS

1. INTRODUCTION

E3G

- **Aim** - E3G's political economy mapping of the global financial ecosystem takes stock of opportunities and challenges for systemic economic and financial reform for climate safety across 14 key countries and institutions ("venues"). It aims to better understand countries and institutions' positions on key aspects of fiscal and monetary policy, and financial regulation, analyse the interactions between these venues, show the main champions and blockers of a progressive sustainable finance agenda, and assess opportunities for green reforms over the next 12-24 months.
- **Method –** E3G is working with a number of in-country partners to develop this research. We have used a mixed-research methodology for each venue – a mixture of desktop research and semi-structured interviews with key stakeholders (policymakers, academics, civil society) following a series of defined research questions. E3G compiles the findings into a presentation for each venue, tests the results internally with other E3G colleagues and then presents the results as appropriate to external stakeholders.
- **Usage –** This research will be used as an internal and external resource to inform civil society and financing strategies for specific countries.

2. CHINA: OVERVIEW OF FINANCIAL SECTOR & KEY INDICATORS

E3G

GDP (Current $US, 2021)	12.2 Trillion
GDP growth (2021)	8.1%
Value add of finance sector to GDP (2020)	8.27%
Share of public & private debt in GDP (2021)	Public Debt: 69.6% Private Debt: 182%
Human Development Index (HDI) Rank: (2021)	86 /189
GHG Emissions: (Mt CO2 eq., 2020)	14,400 (1.7% higher than 2019)
Country rating: (2018)	A1 (Moody's)

TOP LINE ASSUMPTIONS – CHINA'S CLIMATE ACTION

E3G

Headwinds

← **China's (and broader BASICS) deflection of attention from their own climate ambition** using the protective shield of championing the interests of developing and climate vulnerable countries on solidarity and climate finance.

← **Nationalistic voices dominating public policy debate,** driven by tensions between China and the west. Pressure from the west alone risks shrinking the space for progressive voices in China and offers vested interests in the fossil economy a free pass by playing the nationalism card.

← **Coal power and emissions continue to grow**: coal power capacity continued to grow in 2020 (38GW); 2021 Q1 emissions grew 15% year-on-year (+9% compared to 2019 Q1), largely driven by coal use in power, metals and materials sectors. China still accounts for half of the world's coal capacity.

Tailwinds

→ **Climate target enforcement with teeth:** some responsibilities to oversee carbon peaking plans development and implementation being transferred from MEE to NDRC. High-level "leading group" headed by economic and foreign policy top officials formed to drive climate policies.

→ **Roadmap for 2030/2060 targets to be published "soon",** according to Xie Zhenhua – China's 2060 covers all GHGs and 2030 roadmap would include measures on coal consumption, renewables, industries, buildings, green finance and carbon pricing.

→ **Positive signals on phase out overseas coal investment:** Green Development Guidelines published by MOFCOM and MEE stressing importance of "adhering to international standards", including UNFCCC; ICBC to publish coal phase out timeline; No finance to coal projects from China in BRI countries in H1 2021.

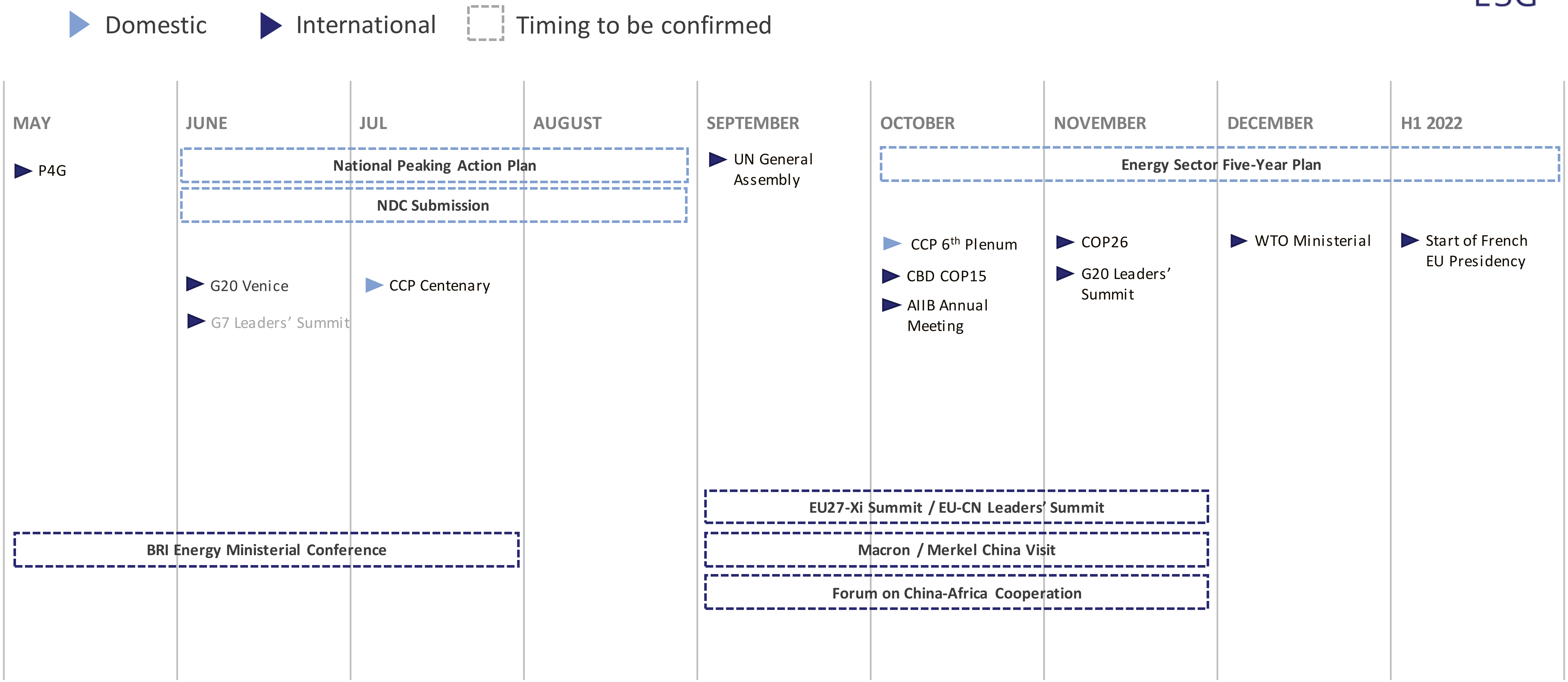
→ **Progress at G20:** China (alongside all G20 countries) is moving closer to supporting 1.5C target and committed to submit new 2030 targets and long-term strategy.

Wildcards:

↔ Escalation of tensions over Xinjiang, Hong Kong, COVID origin investigation, Olympic boycott - raises risks of COP26 'blame game'

↔ China's response to CBAM and impact on COP26 negotiations

CHINA – POLICY AND DIPLOMATIC CALENDAR 2021



CHINA: OPPORTUNITIES AND BARRIERS TO A GREEN RECOVERY

E3G

- China's 2020 stimulus can only be partly classified as "green," with public investment supporting green initiatives that were outweighed by fossil fuel support.
- As China moves from stimulus spending to recovery and long-term development, the implementation of the 14th five-year plan (FYP) will serve as the critical green transition programme.
  - The 14th FYP acknowledges that energy efficiency gains, electrification, and energy mix transformation will contribute to long-term carbon emissions reduction and for the first time in the history of FYP refers to China's longer-term climate goals.
  - Four of the 20 binding economic and social development targets set out in the 14th FYP are devoted to energy and climate change, meaning that the central government is determined to achieve them as part of its political KPIs. The most important binding targets introduced in the 14th FYP are reducing CO_2 intensity by 18% in 2025 and energy intensity by 13.5%.
- China's financial institutions are among the largest overseas investors in the world. Climate considerations have played a limited role so far but have garnered interest by China's policy banks.
- Green finance still only accounts for a small share of finance in the overall Chinese financial system. China still remains the world's largest public financier of overseas coal plants: The Export-Import Bank of China and the China Development Bank accounted for US$15.6 billion, or 50 percent of global public finance commitments in overseas coal fired power plants that reached financial closure between 2013 and 2018, or 40 percent by generation capacity.
- China is among the largest creditors to foreign governments. China's Ministry of Finance has participated in the G20 Debt Service Suspension Initiative (DSSI). However, the DSSI does not go far enough, does not fix underlying structural problems and calls for further debt relief and restructuring are mounting.

CHINA: ASSESSING THE GREENNESS OF ECONOMIC STIMULUS / RESPONSE TO COVID-19

E3G

> The 2020 stimulus can only be partly classified as "green"

- At the end of 2020, China's total fiscal spending on pandemic stimulus amounted to USD 904 billion, equivalent to 6.1% of its GDP which is relatively low compared to other G20 economies. The PBoC also provided monetary support. Public investment has been the main driver of domestic growth. China's economy recovered its pre-pandemic momentum in the last quarter of 2020 and reached 2.3 % GDP growth in 2020.
- In 2020, the Chinese government launched a 3 trillion RMB ($1.8 trillion) new program called "New Infrastructure", aiming for investment in seven technology-intensive industries, including 5G, AI, and data centers. Spending on green, low-carbon transport was also increased. Railways in particular gained extra fiscal support from the central government of RMB 100 billion ($16 billion). NEV consumption and big-scale construction of NEV charging points were also promoted.
- Carbon Brief conducted a study in which they analysed major project lists for 8 provinces that are key energy producers and consumers, that account for 50% of the China's CO_2 emissions, with a tendency to favour fossil-fuels. According to their analysis, one third of all the money 6200 bn RMB ($910billion) would go to transport and energy investments, and if the investments from the list go ahead, the spending earmarked for fossil fuels (2,141 billion RMB) would be six times bigger than for renewables (333 billion RMB). Investments in railways top the list with 2172 bn RMB of planned investments in these provinces. Projects related to energy storage (22 bn RMB), electric vehicles (32 bn RMB) electricity transmission (90 bn RMB) and ecological protection (101 bn RMB) were also on the list.

CHINA: INTEGRATION OF CLIMATE-RELATED RISKS INTO THE FINANCIAL SYSTEM

E3G

> The understanding of the relationship between finance and climate change is gradually increasing in China, supported by the development of Ecological Civilization (生态文明), already endorsed by Hu Jintao in 2007, which became the main green rhetoric of the Chinese Communist Party. In the same year, China started to formulate a series of green credit policies.

> China is mobilising a wide range of financial policy tools from central banking and financial regulation to taxonomies and guidelines. Two of the most effective are monetary incentives and disclosure requirements.

- The PBoC has allowed banks to use their green bond assets as collateral to apply for loans and gave priorities to such collateral. This "carrot", together with local governments' green loan discount rate policy has been the best-known "green benefit" for commercial banks. The upcoming announcement from the China Security Regulator Commission on mandatory ESG disclosure for listed companies is expected to accelerate ESG investment.

> However, compared to the total financial system, green finance still accounts for only a small proportion.

- The average green loan ratio for four major commercial banks is around 8% and has stayed stable for the past five years. Labeled green bonds account for 0.54% of the overall bond market.

> Overcoming challenges such as differences between various green standards, improving capacity in green finance, building stronger monitoring and reporting systems, and strengthening local provincial level policy support can hopefully accelerate China's green finance development. Above all, dis-incentives and specific guidance to drive the transition of the non-green sector is perhaps more crucial and must be introduced on a large scale.

> Climate considerations have played a limited role but have increased in China's overseas finance by its policy banks. Further overseas investments by Chinese financial institutions need to focus on the expansion of renewable energy and phase-out of coal, ideally other fossil fuel too, in order to strongly support climate mitigation.

HOW CHINA POSITIONS ITSELF IN MULTILATERAL INSTITUTIONS

E3G

> China is among the biggest creditors for foreign governments.

> After the outbreak of COVID-19, the debt sustainability issue has become even more critical for developing countries and the calls for debt relief have accelerated. China's recent (public) position on debt restructuring or relief for developing countries has been fairly consistent. Several messages have been highlighted by spokespersons from the Foreign Ministry, Vice Minister of Commerce, Minister of Finance and former central bank governor:
   - the debt issue in developing countries is a long-standing one, and is essentially about the under-development of these countries;
   - multilateral development banks and private creditors account for a large part of the debt structure of HIPCs, and bear a greater responsibility in debt relief;
   - China is committed to addressing debt issues in developing countries through investment and cooperation that boost their domestic sustainable growth.

> In April 2020, China endorsed the G20 DSSI that temporarily suspended debt service payments from the poorest countries to official bilateral creditors. The current deadline for the suspension has been extended through December 2021.

> In October 2020, G20 countries, including China, agreed to the "Common Framework for Debt Treatments beyond the DSSI", which requires the G20 and Paris Club countries to coordinate debt treatments for up to 73 low-income countries eligible for DSSI.

> For interest-free loans, China has made several announcements of debt forgiveness to African countries throughout the past 20 years. For concessional loans (provided by China Exim Bank) and commercial loans (provided by commercial banks such as ICBC), direct debt forgiveness is never an option. Instead, debt restructuring deals (including e.g. debt-for-equity swaps) are negotiated.

RECOMMENDATIONS FOR ACTION

1. **Raising domestic climate ambition and mitigating transition risk: To keep 1.5C target within reach, China needs to peak its emissions no later than 2025 and start reducing emissions ahead of 2030:**
   - The forthcoming Peaking Action Plan and the 10 sectoral action plans are an opportunity for China to step up its climate ambition. This would entail commitments on: peaking emissions before 2025; limiting new coal at the national and/or provincial level before 2025 or a 'no net new coal' commitment; phasing out unabated coal from the power system by 2040; and retiring all subcritical power plants by 2030. Complementary measures from the Chinese government and regulator to align public outward investment, including from state-owned enterprises, with Paris Agreement goals would both support an ambitious transition and mitigate transition risks by lessening the risk of asset stranding.

2. **Sectoral decarbonisation planning: in addition to prioritising the expansion of green finance, China should support the transition of carbon intensive industries:**
   - Taking into consideration high carbon intensity of the Chinese economy and scale of heavy-emitting industries, instead of a complete divestment from fossil fuel companies, a more realistic solution is to support the transition of heavy-emitting industries and promote transitional finance. This would also mitigate transition risk. This could entail, for example, sustainability linked bonds.

3. **Global green recovery and multilateralism: As a globally significant international creditor and a critical power in multilateral fora and institutions, China should support the greening of international investment and ensuring a global green recovery:**
   - This would entail: Commitments from China to end public support for unabated international thermal coal power generation as soon as possible; Commitment from China, as the largest shareholder in the AIIB and a significant shareholder of the NDB, ADB, IMF and World Bank, to actively promote efforts to reform MDBs; Commitments from China to support debt relief and liquidity provisioning.

ACKNOWLEDGEMENTS

This presentation was based on a report written by the International Institute for Green Finance (IIGF) as part of E3G's global financial ecosystem mapping initiative: Wang, Y., Nedopil, C. and Janus, A. (2021), *Political Economy Mapping of China's financial ecosystem.*

The IIGF is a leading think tank on green finance based in Beijing, China. It is part of the Central University of Finance and Economics. IIGF works with partners in 25 countries to accelerate green finance harmonization and application in China, the Belt and Road Initiative and globally. It was founded in 2016 by Prof. Yao Wang and has 50 full-time staff.

E3G is an independent climate change think tank accelerating the transition to a climate-safe world. E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change. E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere.

ANNEX

REFERENCES

> GDP: World Bank Data, see https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=CN

> Projected GDP growth (2020-21): IMF, World Economic Outlook (April), see https://www.imf.org/en/Publications/WEO/Issues/2021/03/23/world-economic-outlook-april-2021

> GDP per capita rank: https://unstats.un.org/unsd/snaama/Basic

> Value add of finance sector to GDP: IMF data , see https://www.imf.org/en/News/Articles/2021/01/06/pr211-china-imf-executive-board-concludes-2020-article-iv-consultation

> Share of public and private debt in GDP: https://www.imf.org/external/datamapper/GGXWDG_NGDP@WEO/GHA?year=2021 https://www.ceicdata.com/en/indicator/china/private-debt--of-nominal-gdp

> Human Development Index (HDI) Rank: UNDP, see: http://hdr.undp.org/en/data

> GHG Emissions: https://rhg.com/research/preliminary-2020-greenhouse-gas-emissions-estimates-for-china/

> Credit rating and outlook: Fitch, see https://www.fitchratings.com/research/sovereigns/fitch-affirms-china-at-a-outlook-stable-28-06-2021#:~:text=Fitch%20Ratings%20%2D%20Hong%20Kong%20%2D%2028,%2B'%20with%20a%20Stable%20Outlook.

Overseas coal financing: https://www.bu.edu/gdp/2021/07/07/who-funds-overseas-coal-plants-the-need-for-transparency-and-accountability/

For all other citations, please contact E3G.