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The AIIB and investment in action on climate change

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Contents

Summary	5
1. Introduction	6
2. The AIIB's approach to infrastructure	7
3. Chinese leadership in supporting low emission and climate resilient development in Asia	9
A focus on low carbon energy and infrastructure is consistent with implementation of Chinese policy priorities	9
China is also 'greening' its financial system, including development banks such as the AIIB	10
An opportunity to expand its status as a renewable energy superpower and change the narrative for overseas investments	11
4. Rationale for action by other AIIB members	12
The AIIB's member states also have compelling reasons to encourage the AIIB to focus on green investment	12
5. Conclusions and recommendations	14
The AIIB can pursue a range of approaches to 'green' its portfolio, including prioritizing low carbon investment	14
References	16

Summary

The Asian Infrastructure Investment Bank (the AIIB or the Bank) is poised to be an important new actor in international development finance, led by developing countries to scale up investment in infrastructure. The choices that Asian countries make about how to meet their infrastructure needs, particularly in key sectors such as energy and transport, will fundamentally affect the planet's ability to achieve low emission and climate resilient development, and keep global temperature changes “to well below” 2°C degrees above pre-industrial temperatures, as stated in the Paris Agreement on climate change.

As a new multilateral development bank (MDB) conceived to tackle pressing development challenges of the 21st century, the AIIB has an opportunity establish a new approach to infrastructure investment that prioritizes renewable energy, climate resilience and sustainable development. Indeed, the AIIB has the potential to exceed the practices of other MDBs in these areas by finding new approaches that resonate with member needs and priorities.

As the founding member of the AIIB and its largest shareholder, there is a strong case for China to support such an emphasis given its leadership in clean energy industries. The AIIB's investments can help expand markets for renewable energy, and change the narrative around the emphasis

of China's overseas investments as one focused on clean sustainable development, rather than resource extraction.

Asian countries are already emerging as leaders in clean energy with new business models that meet the needs of poor people within poor countries. Most countries in the region are also highly vulnerable to the impacts of climate change. A focus on low emission paths to sustainable development represents an investment in a future with major long-term commercial benefits for many members of the AIIB.

The Intended Nationally Determined Contributions (INDCs) that Asian countries have proposed and their emerging priorities with respect to achieving the Sustainable Development Goals (SDGs) provide a basis for the AIIB to develop its investment strategies.

The AIIB should set targets around clean energy investment, and developed country members could make concessional funds available to support the achievement of these goals. Incentives should be structured so staff emphasise low emission development options and climate resilience. Tools such as the use of carbon footprinting and shadow pricing to reflect the externalities of fossil fuel emissions should be used to inform the AIIB's investment decisions. Such measures could enable the Bank to achieve its stated aim to be “lean, clean and green”.

1. Introduction

The AIIB was launched in January 2016 with USD 100 billion in authorized capital. China and India are its largest shareholders alongside 55 other members and prospective members. The AIIB's inauguration took place in the context of growing interest in the financial sector about climate change, and a month after 195 countries – including the AIIB's members and prospective members – adopted the Paris Agreement on climate change, which stated among its goals that financial flows should be “consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.”¹

Given the AIIB's focus on infrastructure, and the significance of its investments for the future emissions trajectory of Asia, the degree to which the China-initiated bank will support low carbon and climate resilient development deserves close attention.² The need for investments in adaptation-related infrastructure will also be substantial. AIIB regional member states, including China itself, are among the most vulnerable countries to the effects of climate change in terms of risks associated with extreme weather, sea level rise, and agricultural productivity loss.³

As a new institution the AIIB has a unique opportunity to take a bold approach to the expansion of renewable energy and sustainable infrastructure in Asia. It can take a proactive stance and prioritize investment in low carbon, climate resilient infrastructure through the design of its policies, operations and investment programs. Although some AIIB member countries may see the new institution as a way to obtain low-cost funding for coal and fossil-fired power plants, there are compelling reasons why it will be in the interest of AIIB member and prospective member

countries, including China, for the AIIB to adopt specific priorities to promote low-carbon infrastructure. By focusing on clean energy and other low-carbon development choices, the AIIB can expand markets for solar, wind and grid technologies, extending China's leadership in the region in a manner consistent with the commitments to take ambitious action on climate change made by its member countries as signatories to the Paris Agreement.

This paper focuses on this opportunity. Section 2 considers the emergent approach of the AIIB to infrastructure finance. Section 3 outlines the rationale for China to push for a forward-leaning stance toward clean energy and sustainable infrastructure, including recent investment trends in renewable energy in China, environmental priorities in the Thirteenth Five Year Plan (FYP), and recent signals that China will begin ‘greening’ its financial system, including overseas development banks. Section 4 highlights the opportunity that a focus on investments in low-carbon energy and sustainable infrastructure would present for the Bank more broadly, including financing for investments in support of their INDCs of action on climate change. Given that the INDCs will be inadequate to keep global warming below 2 degrees above pre-industrial levels,⁴ an overriding goal of the Paris Agreement, the key challenge before the international community is not just to deliver the INDCs but to exceed them. Section 5 provides conclusions and recommendations, including specific steps that China and other AIIB members and prospective member states can take to ensure that the AIIB is part of the solution to the challenge of climate change and sustainable development, rather than increasing regional and global downside risks.

1 UNFCCC (2015b), Article 2, paragraph 1 (c)

2 See Ballesteros and Leung (2015), BIC (2015), Hu et al. (2015), Lowell and Short (2015), Morris (2015), Santos (2015) and Qin (2016).

3 For country rankings of climate impacts in terms of direct risks to extreme weather, sea level rise, agricultural productivity loss and overall vulnerability, see Wheeler (2011)

4 See UNFCCC (2015a); also see https://unfccc.int/files/focus/indc_portal/application/pdf/synthesis_report_-_brief_overview.pdf

2. The AIIB's approach to infrastructure

According to the Asian Development Bank (ADB), Asia requires approximately USD 8 trillion in national infrastructure investment between 2010 and 2020⁵ – including USD 3.2 trillion in new energy (electricity) related infrastructure⁶ – and USD 287 billion in specific regional infrastructure projects for an average overall infrastructure investment of USD 750 billion per year.⁷

The AIIB has taken important steps to address climate change as it develops its investment portfolio strategy. Its website describes its *modus operandi* to be “lean, clean and green”, “built on respect for the environment,”⁸ with target projects that are “financially, environmentally and socially sustainable.”⁹ Infrastructure is of course central to the Bank’s mandate, and the investment opportunity will be substantial. The AIIB’s new president Jin Liqun has stressed this mode of operation.¹⁰

Consistent with these broad stated goals the AIIB has also adopted Environmental and Social Safeguards¹¹, which include specific reference to climate change:

The Bank supports the three aims of the Paris Agreement of December 2015 to strengthen the global response to the threat of climate change, which are related to mitigation, adaptation and the redirection of financial flows. It supports the global adaptation goal of enhancing adaptive capacity, strengthening resilience and reducing vulnerability to climate change. In the context of sustainable development, the Bank stands ready, through its financings, to assist its Clients in achieving their nationally determined contributions, including through mitigation, adaptation, finance, technology transfer and

*capacity-building. It may, through its financings, support Clients’ formulation of long-term low greenhouse gas emission development strategies. The Bank recognizes the challenges presented by climate change and the need to support both mitigation and adaptation measures in a Project facing such challenges. The Bank supports its Clients in their evaluation of both the potential impacts of the Project on climate change and the implications of climate change on the Project. To this end, the Bank plans to prioritize investments promoting greenhouse gas emission neutral and climate resilient infrastructure, including actions for reducing emissions, climate-proofing and promotion of renewable energy.*¹²

In addition, the AIIB encourages renewable energy and low-carbon technologies:

*The Bank recognizes the importance of green economic growth and the long-term benefits that it will provide in Asia. The Bank aims to build upon existing green economic growth initiatives in Asia, and to provide support for new ones at the regional, national and subnational level and within the private sector. Planning, investment and capacity building measures that the Bank supports help to “green” both infrastructure and interconnectivity. The Bank: promotes the conservation of energy, water and other resources; supports sustainable land use management; and encourages making best use of green growth and low-carbon technologies, renewable energy, cleaner production, sustainable transport systems and sustainable urban development.*¹³

5 USD 5.4 trillion in new infrastructure and USD 2.6 trillion in replacement infrastructure

6 ADB and ADBI (2009), Table 5.1, page 167. Updated estimates for AIIB regional member countries put the total infrastructure needed in regional member countries at USD 8.2 trillion; see Bhattacharyay 2010, page 12.

7 ADB and ADBI (2009)

8 See <http://www.aiib.org/html/aboutus/introduction/aiib/>

9 See Xinhua (2015b)

10 See Martina (2015) and Yao (2015)

11 See <http://www.aiib.org/uploadfile/2016/0226/20160226043633542.pdf>

12 AIIB (2016c), p. 5

13 AIIB (2016c), p. 5

The AIIB Articles of Agreement and financing policy state that the Bank “shall ensure that each of its operations complies with the Bank’s operational and financial policies, including without limitation, policies addressing environmental and social aspects.”¹⁴ An environmental and social assessment of each project¹⁵ that includes an assessment of “potential trans-boundary and global impacts, including climate change as they relate to the Project”¹⁶ is required.¹⁷

The AIIB’s environmental and social safeguard policies have been informed by those of existing MDBs; their implementation could be aided through the use of tools that other banks have developed to assess environmental, social and economic costs. Attention to the environmental, social and economic costs of investment in fossil fuels, including through use of carbon shadow pricing and other tools, can make an important contribution. As Wheeler (2008) noted: “If we are already past the safe limit for atmospheric loading, then it obviously makes no sense for [public lending agencies] to treat carbon emissions as costless.”¹⁸

This foundation provides a solid basis for the AIIB to take a bold, proactive approach to financing renewable energy and low-carbon infrastructure. Nevertheless, the proof will be in the Bank’s actual investment portfolio.

Ongoing deliberations about the approach to be taken in Indonesia’s engagement with the AIIB have brought this issue to the fore.¹⁹ Indonesia has been keen to be first in line to access the AIIB, reportedly preparing six projects for AIIB financing with combined costs exceeding USD 2 billion. Among the proposed projects is a request to finance the state utility PLN’s plans to develop 10 GW of electricity. Indonesia plans to add more than 35 GW of new generation capacity, of which more than half could

come from coal. Towards the end of 2015, Indonesian government representatives were reported to be considering accessing AIIB funding for the coal-fired components of its energy expansion plans²⁰, although officials clarified the exact approach was still to be determined.²¹

Indonesia’s INDC, however, stresses existing policy commitments to increase the share of new and renewable energy to at least 23 percent by 2025, and its interest in developing clean energy sources.²² The country’s INDC also emphasized the importance of strengthening the archipelago nation’s resilience to the impacts of climate change, and the key role of renewable energy alongside improved land use management, water and governance in this context. With abundant fossil fuel reserves including coal and oil, de-carbonisation of energy has long posed a challenge for Indonesia; but the country also has huge potential geothermal, solar, and wind energy reserves. Similarly, in urban areas, the potential for investments in energy efficiency and sustainable transport that deliver development co-benefits is also immense.

While many international partners have sought to support efforts to scale up low carbon energy, progress has been slow, though some signs of success are now emerging. The AIIB could play an important role in helping Indonesia accelerate delivery on these policy objectives. The degree to which the AIIB succeeds will hinge on commitment from in-country counterparts on working with the AIIB to structure and execute clean energy investments. To adhere with the AIIB’s stated aim to be “clean and green”, potential costs and externalities of investments in fossil fuels will need to be carefully assessed. The impacts of climate change, and opportunities to strengthen resilience to climate change through infrastructure investments will also be important considerations.

14 See AIIB (2016a), p. 9, Article 13, para. 4; and AIIB (2016b), p. 3, section 3.1.3 (d)

15 AIIB (2016c), p. 24

16 AIIB (2016c), p. 28

17 AIIB (2016c), p. 28

18 See Wheeler (2008), p. 5

19 Jakarta Post, 15 January 2016, RI to propose six projects to AIIB for financing. <http://www.thejakartapost.com/news/2016/01/15/ri-propose-six-projects-aiib-financing.html>

20 Jakarta Globe, 21 November 2015. AIIB \$1b to Finance Coal Development in Indonesia. <http://m.thejakartaglobe.com/business/aiib-1b-finance-coal-development-indonesia/>

21 Jakarta Globe, 25 November 2015. No Deals Yet With AIIB on Coal-Fired Plants: Finance Ministry. <http://jakartaglobe.beritasatu.com/business/no-deals-yet-aiib-coal-fired-plants-finance-ministry/>

22 See Indonesia’s INDC, p. 2. http://www4.unfccc.int/submissions/INDC/Published%20Documents/Indonesia/1/INDC_REPUBLIC%20OF%20INDONESIA.pdf

3. Chinese leadership in supporting low emission and climate resilient development in Asia

As the founding member of the AIIB, its largest shareholder, and its prime beneficiary in terms of reach and influence, China has a number of reasons to support the AIIB's focus on clean energy, and low-carbon, climate resilient infrastructure. China can help ensure that new infrastructure built in coming years avoids 'locking-in' an emissions trajectory that threatens future regional and global prosperity.

The opportunity for the AIIB to finance climate change mitigation investments also corresponds to China's own self-interest and aligns closely with China's own recent policy decisions to promote green development. A focus on clean energy and low-carbon infrastructure serves the commercial interests of many countries in the region – particularly China – as a means to help secure new export markets for key industries, such as solar energy, wind turbines systems, energy efficiency, and electrical grid technologies.²³

By emphasizing renewable energy, China can also help reduce over-capacity in key domestic industries such as solar²⁴ through increased demand in the region, as well as access new markets for complementary industries such as smart grid technologies.²⁵ By focusing the AIIB on the requirements of an environmentally sustainable future, China can align the new institution's policies and

operations with its own strategic investment priorities, its next Five Year Plan (FYP), and recent steps to 'green' the country's financial system.

A focus on low carbon energy and infrastructure is consistent with implementation of Chinese policy priorities

Over the past decade, driven by concerns about reducing air pollution, improving energy security and promoting growth in strategic clean technology industries²⁶ China has pursued a low-carbon investment strategy and has established itself as a renewable energy leader, fostering dynamics that have lowered prices and have expanded the market. In the five years to 2012, investment in renewable and nuclear energy rose by 40 percent while investment in fossil fuel generation fell from 50 percent to 25 percent.²⁷ By 2013, wind, hydroelectric and solar comprised 30 percent of generating capacity and 20 percent of electricity generation,²⁸ enabling China to reach its 2015 target two years ahead of plan.²⁹ In the eight years to 2013, China became the largest wind power generator in terms of total capacity and capacity added per year.³⁰ In the five years to 2014, non-fossil generation capacity increased 73 percent to 444 GW.³¹

23 For discussion on the AIIB and energy efficiency, see Belenky (2016)

24 See Anderlini (2013) and Poon (2015)

25 See Finnamore (2016a)

26 Fergus and Stern (2016) and Mathews and Tan (2014c)

27 Mathews and Tan (2014b)

28 Mathews and Tan (2014a)

29 Mathews and Tan (2014b)

30 Mathews and Tan (2014a)

31 Fergus and Stern (2016)

In 2015, China spent USD 110.5 billion on clean energy technology, 17 percent more than in 2014³² and added more wind capacity than the European Union.³³

China's 'One Belt, One Road' initiative, involving port, railway, road, power and grid infrastructure, also creates enormous opportunities and needs to ensure that new infrastructure will be sustainable and withstand the foreseeable stresses and shocks resulting from a warming climate.³⁴

China's INDC summarizes the country's achievements and highlights its future plans particularly with regard to low-carbon energy. By 2014 China had installed 300 GW of hydropower (2.57 times more than in 2005), 95.8 GW of wind power (90 times more than in 2005) and 28 GW of solar power (400 times more than 2005).³⁵ China commits to "accelerate the transformation of energy production and consumption and continue to restructure its economy, optimize the energy mix, improve energy efficiency and increase its forest carbon sinks."³⁶ China's INDC notes China's "sense of responsibility to fully engage in global governance, to forge a community of shared destiny for humankind and to promote common development for all human beings."³⁷ Pressing concerns related to air pollution, citizen health, and energy security are prompting a re-assessment of the viability of continued investment in coal domestically. China recently announced it would halt construction of coal-fired power plants in 15 regions and would stop approving new projects in as many as 13 provinces and regions until 2018.³⁸

As a result of China's recent investments in renewable energy – 22 GW in hydroelectric, 21 GW in wind, and 11 GW in solar in 2014 alone – and its policy shift to a less emissions-intensive, slower model of growth – the 'new normal' – China may outperform its target reduction of 40-45 percent in emissions per unit of GDP by 2020³⁹ and emissions may even peak before 2025, well before the country's commitment to reach peak emissions by 'around 2030.'⁴⁰

China's Thirteenth FYP emphasizes environmental sustainability as a key theme, specifies creation of an "ecological civilization" as a priority development target⁴¹ and supports expansion in the environmental protection sector.⁴² Green development,⁴³ protection of the environment and pursuit of environmentally friendly growth⁴⁴ are key elements that build on the progress of the previous FYP alongside new efforts to green China's financial system as a way to help prevent and remediate environmental damage resulting from China's earlier export-led growth.⁴⁵

China is also 'greening' its financial system, including development banks such as the AIIB

The Research Bureau of the People's Bank of China and UNEP Inquiry into the Design of a Sustainable Financial System recently co-sponsored a Green Finance Task Force, which recommended that:

Overseas investment and development institutions should adopt internationally consistent standards. The Silk Road Fund, the Asian Infrastructure Investment Bank (AIIB), and the New Development Bank should adopt or reference the Equator Principles, establish a system for environmental risk management with standards no lower than those set by the World Bank and the Asian Development Bank, disclose environmental information to the fullest extent, promote overseas green investment, and shape and maintain China's image as an environmentally and socially responsible country.⁴⁶

32 Randall (2016) and Mills and McCrone (2016)

33 GWEC (2016)

34 For an overview, see Xinhua Finance Agency <http://en.xinfinance.com/html/OBAOR/>. For details on projects that have been proposed, see Zhu, Li and Qu (2015)

35 Peoples Republic of China (2015), pp. 3-4; also see Mathews (2015)

36 Ibid.

37 Op. cit., p. 2

38 Chen and Stanway (2016)

39 Lin (2016) and Gan and Jing (2016)

40 Fergus and Stern (2016) and Harvey (2016)

41 For an overview of the 13th FYP, see Xinhuanet (2015) and Zhu et al., Yan, He and Wang (2015)

42 Xinhua (2015a)

43 See Finnermore (2016a) and (2016b)

44 See Kumar and Thurlow (2016)

45 See Jun and Zadek (2015)

46 People's Bank of China and UNEP (2015b) pp. 18-20; also see People's Bank of China and UNEP (2015a) and (2015c)

A new focus on opportunities to invest in clean energy is now infusing the investment strategies at the New Development Bank. China is now also leading the G20 task force on Green Finance.⁴⁷ The China Council for International Cooperation on Environment and Development (CCICED), an influential high-level advisory body, convened a task force in 2015 that also recommended that China green overseas investment. The CCICED task force specifically recommended that China “adhere to the principles of green finance in China’s overseas investment” and *inter alia* “(1) integrate principles of sustainability into collaboration with countries receiving finance from the AIIB, [BRICS New Development Bank] and the Silk Road Fund; (2) require financial institutions to establish and implement a standard for environmental and social risk management; (3) require financial institutions to set green investment targets and reduce their support for polluting industries.”⁴⁸

An opportunity to expand its status as a renewable energy superpower and change the narrative for overseas investments

By focusing the AIIB early on clean energy and sustainable infrastructure, China can capture synergies between expertise cultivated from its own domestic development and the AIIB’s investments overseas. The AIIB’s ability to

provide expertise in designing high-quality projects will be key to its success, as Humphrey (2015) has noted: “The AIIB could carve a very relevant niche for itself by specialising in accumulating and sharing experience on complex infrastructure projects – a set of skills sorely needed in developing countries.”⁴⁹ China also has the opportunity to foster new markets for solar and wind energy and other forms of sustainable infrastructure, and thereby continue to drive down costs.

Importantly from a geopolitical standpoint, by focusing the AIIB on mobilizing the investment required for a 2 degree future rather than on benchmarking its practices against existing institutions, China can ‘leapfrog’ to a new set of best practices⁵⁰ and change the broader narrative around the overall purpose and objective of its overseas investments. The narrative around China’s overseas investment has tended to focus on extractive resources and weak enforcement of environmental and safety standards, which has had less favourable reputational impacts with many stakeholders. By encouraging the AIIB’s investment on clean energy and sustainable infrastructure, China has the chance to transform the narrative to one centered on long-term responsibility and environmentally sustainable development.

47 <http://www.unep.org/newscentre/default.aspx?DocumentID=27058&ArticleID=35902>, <http://climate-iiisd.org/events/g20-green-finance-study-group-meeting/>

48 CCICED (2015), p. 79

49 See Humphrey et al. (2015), p. 7; for discussion of the prospects for the AIIB, see Humphrey (2015).

50 See Zhu, Leung and Horn-Phathanothai (2015)

4. Rationale for action by other AIIB members

The AIIB's member states also have compelling reasons to encourage the AIIB to focus on green investment

The investment requirements needed to achieve a future “well below 2°C above pre-industrial levels,”⁵¹ create a strong rationale for the all of the AIIB's members to support the Bank to take a forward-leaning approach toward investment in clean energy and sustainable infrastructure.

All of the AIIB's 57 members and prospective members have already stated their intention to act on climate change, and have submitted INDCs. Their INDCs therefore provide a starting point or framework for development of the AIIB's programming strategies in member countries. As Cochrane et al. (2015) point out: “The structuring of strategic intervention frameworks to support low-carbon climate-resilient development and respect long-term transition objectives is perhaps the most important step to ensuring that an institution's activities support the mainstreaming of climate and the [low-carbon climate resilient] transition.”⁵²

For example, India, the second largest shareholder in the AIIB,⁵³ is reportedly considering approaching the AIIB for finance for project proposals developed by the ministries of agriculture, rural development, water resources and railways.⁵⁴ These sectors are key to the Indian economy's resilience to the impacts of climate change, and also present opportunities to adopt more efficient and innovative practices that will support low emission development. In addition to being well placed to offer immediate development gains, including in the context of the SDGs, investments in these sectors also play a prominent role in India's INDC.

Many of the AIIB's members, in addition to China, have fostered significant renewable energy industries and other businesses that can support the transition to low emission and resilient development (including, for example, information technology systems that can support smarter grid systems). European and Indian companies, for example, are particularly prominent in global clean energy markets.⁵⁵ AIIB programming focused on clean energy could help incubate, centralize and share good practices. Part of the strategic interest of Asian countries in creating the AIIB is to create a multilateral bank that is better connected to their national institutions, and better reflects regional needs and priorities: the AIIB should therefore have the potential and legitimacy to bring a new set of key national institutions including ministries of finance, ministries of energy, and utilities into such efforts with the promise of long-term benefits.

The AIIB's emphasis on these sectors can also help create new export opportunities for these industries in the region. This emphasis would further reinforce positive market dynamics that favour the transition to low carbon energy. It will also help member countries invest in creating the jobs of the future and increase employment. An emerging body of research and analysis suggests that “new investments in energy efficiency and renewable energy will generate more jobs for a given amount of spending than maintaining or expanding each country's existing fossil fuel sectors.”⁵⁶

Any impact that the AIIB can have in supporting a larger scale integration of low carbon options into the energy system that reduces costs and enhances affordability will have enormous benefits for all AIIB members and indeed all countries. Market expansion will help continue to drive down costs and enhance affordability

51 UNFCCC (2015b), p. 2

52 See Cochran et al. (2015), p. 20; also see Humphrey et al. (2015), p. 10

53 See China Daily (2015)

54 See Chaudhury (2015)

55 See REN21 (2016) Renewables 2015 Global Status Report

56 See UNIDO and GGGI (2015), p. 17

of low-carbon technologies and improve the viability and affordability of low emission options.

In addition, most Asian countries are extremely vulnerable to the impacts of climate change. Fast-growing, low-lying Asian cities are likely to be amongst those most affected by the impacts of climate change, and poor people within these cities the most vulnerable to its impacts.⁵⁷ Incorporating climate risk into development across Asia is an urgent imperative, and the AIIB can play an important role in advancing these efforts. Unabated climate change on the other hand will have devastating impacts for Asian economies and poor people in Asian countries, potentially reversing hard won development gains.⁵⁸

Finally, G7 and European members of the AIIB are also already under substantial pressure to ensure that their international public spending is coherent with efforts to

advance low emission and climate resilient development, particularly as they seek to scale up spending on solutions to climate change. The 2015 G7 Declaration included pledges to “incorporate climate mitigation and resilience considerations into our development assistance and investment decisions” and to eliminate subsidies for fossil fuels, including through international spending and export credit support.⁵⁹

By helping to promote the technologies of the future in infrastructure subsectors related to renewable energy, energy efficiency, low-carbon transport, agriculture, and water, the AIIB’s members can also support improvement of their own practices and also expand the portfolio of options available in the future to address climate change. Focused efforts to this end can increase the potential for positive spillover effects including through lower prices due to market expansion.⁶⁰

57 ADB, Asia’s Booming cities most at risk from climate change. <http://www.adb.org/news/features/asias-booming-cities-most-risk-climate-change>

58 ODI, 10 things to know about climate change and finance for development, London 2015

59 G7 Leaders Declaration 7-8 June 2015. https://sustainabledevelopment.un.org/content/documents/7320LEADERS%20STATEMENT_FINAL_CLEAN.pdf

60 See Stern (2006), pp. 253-255, 407-409

5. Conclusions and recommendations

The AIIB can pursue a range of approaches to 'green' its portfolio, including prioritizing low carbon investment

Rapid scale-up of clean and resilient infrastructure would confirm the AIIB's pivotal role as a future-oriented multilateral institution financing the transition to sustainable low emission and climate resilient economy. Such an approach would foster emergent geopolitical, commercial and business interests in clean energy and resilience across the region, including in countries such as China and India, strengthen the economies of AIIB recipients, and support fulfillment of the objectives that the AIIB's members and prospective members have made as signatories to the Paris Agreement.

Investment in coal-fired power, on the other hand, would undermine the AIIB's credibility in its stated goal to be "green, clean and lean." Moreover, such a step would be a missed opportunity for China, which led the AIIB's creation, to play a transformational role in shaping the development trajectory of Asia toward a sustainable future.

With the AIIB's stated goals in mind, the following specific interventions could give the AIIB a robust and credible approach to incorporating climate change into its operations and investment decisions:

- **Start with INDCs and the SDGs as a framework for programming and for developing investment decision criteria.** By establishing country program plans, and by framing the country plan in terms of the country's INDC as well as the SDGs agreed in 2015, the AIIB can ensure its investment activities are consistent with the country's INDC, and also that possible synergies between different sectorial interventions are fully captured. The AIIB should ensure its investments are consistent with
- recipient countries' adopted climate targets, policies and long-term ambitions, and can be justified in the context of the goals set in the Paris Agreement.⁶¹ The objectives of preserving a livable climate and achievement of the SDGs are highly interconnected and directly affect countries in Asia whose growth trajectories could exacerbate climate change and whose economies are among the most vulnerable to potential climate related risks.
- **Set targets for low-carbon investments.** To incentivize lending toward green investments, the AIIB can set targets, either in percentage or absolute terms, for its lending for clean energy and other forms of sustainable infrastructure. By carving out a part of its portfolio to be dedicated to green investments, the AIIB can signal to potential borrowers that it is committed to operationalize its stated priorities, develop internal expertise and project development capabilities in a growing market segment, and secure a leading position in infrastructure finance. Developed country members of the AIIB should make concessional and grant finance available through the AIIB to enable it to finance low-carbon opportunities that might otherwise be less attractive on purely financial terms. Such measures have played an important role in increasing the focus on adaptation and mitigation investments at existing MDBs, and de-risking these investments so they could be pursued.
- **Create staff incentives for promoting green programs.** As a further boost to incentivize results in line with overall strategic objectives, the AIIB can build capacity and create incentives for the AIIB staff to prioritize low-carbon infrastructure and climate risk in their interventions. Such incentives have played an important role in elevating attention to climate change considerations in economic planning and development within other large MDBs.⁶²

61 See Rydge et al. (2015)

62 See Nakhooda (2008), p. 17

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- **Adopt a carbon footprint benchmark.** Consistent with the idea of adopting best-in-class standards, the AIIB can adopt a carbon footprint benchmark, or an emission performance standard (EPS) (gCO₂/kWh), above which the Bank will not finance fossil fuel projects, similar to the approach applied by the various MDBs, including the European Investment Bank (EIB).⁶³ The AIIB could build on an example such as the EIB's EPS, or develop its own approach taking the goals set by the Paris Agreement into account. In the exceptional case where the AIIB finances or co-finances a fossil fuel-related project, the AIIB should consider the full costs of fossil fuel investments including environmental and social externalities, and provide rigorous analysis showing that there is no cleaner, safer and less polluting alternative.
 - **Apply a 'shadow' carbon price to fossil fuel-related investment evaluations.** The purpose of a 'shadow' carbon price is to reflect the social cost of emissions in CO₂ emitting projects. Initial levels could use China's own new carbon market for reference. The intent of such a practice is to ensure "renewed attention to energy project analysis, using fully-accounted levelised

energy costs and appropriate accounting charges for carbon emissions."⁶⁴ A growing number of public and private organizations including banks are starting to use such methodologies to assess carbon related risks and opportunities in prospective investments.⁶⁵

The AIIB was created to fill important gaps in the international financial architecture, giving developing countries much greater representation in its governance and investment strategies, and mobilizing much needed public finance for Asia's infrastructure finance agenda. As a new MDB "conceived for the 21st century"⁶⁶ the AIIB has an opportunity to out-perform its counterparts by taking an ambitious approach to investing in renewable energy, climate resilience and environmentally sustainable development from the outset, rather than locking in polluting conventional technologies and approaches. By taking a proactive approach to seizing this opportunity, the AIIB can reduce climate change risks and help ensure achievement of broader sustainable development goals in Asia, secure an enduring leadership position among multilateral banks, and shape the region's development and emissions trajectory.

63 See EIB (2013), p. V, 26, 27

64 See Wheeler (2008), p. 14

65 See CDP (2015); also see Kossoy et al. (2015), p. 48

66 See <http://www.aiib.org/html/aboutus/introduction/aiib/?show=0>

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