

# **Luxembourg's Green Finance: Bridging the gap in major climate battlegrounds**

*How Luxembourg can use its influence as a green finance center for higher environmental standards in China*

*by Lauren Huleatt and Martina Holbach*

Despite having one of the highest per capita greenhouse gas emissions in the world, Luxembourg's emissions as a portion of the global total remains miniscule. But when it comes to shaping the global energy mix, Luxembourg holds disproportionate influence. As a "green" finance center and key gateway for investments into China, Luxembourg policymakers are well positioned to influence energy policy in Asia, particularly when it comes to polluting coal.

Luxembourg's hold as the link between Europe and China is strong. 79,5% of European assets invested in Mainland China are Luxembourg funds. 30,9% of global investment funds investing in China are Luxembourg domiciled funds. Over the last 40 years, seven major Chinese Banks have set up their EU hubs in Luxembourg, establishing Luxembourg as China's de facto gateway to the European Union.

Chinese banks and their entities that are regulated in Luxembourg are among the top global funders of coal. These include China Construction Bank, Industrial and Commercial Bank of China, Bank of China, and Agricultural Bank of China, which are the world's top four banks regarding coal mining and coal power financing. Although China is a world leader in renewable energy production and development, coal has remained its dominant energy source both domestically and overseas. And despite Luxembourg boasting its green finance center, the country has not shown the public that it has tried to use its position to influence financial flows from these institutions into coal.

But for Finance Minister Pierre Gramegna, an opportunity to leverage Luxembourg's position lies just days away. On July 12 and 13, the Asian Infrastructure Investment Bank (AIIB; the Bank), China's multilateral development bank (MDB), will hold its Annual Meeting in Luxembourg. Approximately 500 delegates and 1500 participants will be expected to attend what will be the AIIB's first Annual Meeting outside of Asia.

The AIIB, which proclaims to be "lean, clean, and green", is China's 21st century answer to the world's largest MDBs - the World Bank and the Asian Development Bank, led by the US and Japan. While the AIIB has remained out of any mining, oil, or coal projects, giving some hope that the AIIB may be a channel for which green investment throughout Asia can expand, its energy policy falls short of the industry best practice in regards to coal power finance by leaving the door open to coal investment. And although it was originally expected to be a sustainability pioneer of the MDBs, approximately 26% of its project portfolio has been invested in fossil fuels, with only one non-hydropower renewable energy project in its portfolio as of 30 June 2019.

In this regard, choosing Luxembourg as the host of the AIIB's fourth annual meeting and first non-regional meeting is certainly an interesting choice by the Bank. Perhaps it is an effort to appear green while continuing business as usual. And despite the fact that Luxembourg was the first European country to apply to join the AIIB back in 2015, it makes up only 0.07% of the Bank's subscribed capital and holds a mere 0.29% of voting power. With 70 member countries around the world, and 26 non-regional members, Luxembourg's contribution puts it in close to the bottom of the barrel.

Nevertheless, the decision seems to reinforce Luxembourg's role as sustainable finance channel between China and the rest of the world. It provides Luxembourg with an opportunity to sit higher on the global stage, now facing Asia, and show what kind of financial center it wants to be. If Minister Gramegna and the Luxembourg government hold true ambitions around climate action, they need to start by wielding their influence and showing their intentions at the AIIB Annual Meeting by pushing to make the AIIB truly green.

### **Even small nations can play a big role in the climate crisis**

It goes without saying that there is no room for new coal investments globally. Scientists agree that for the average global temperature rise to be limited to 1.5°C, coal consumption must be cut by at least two thirds by 2030, and to almost zero by 2050, according to the Intergovernmental Panel on Climate Change (IPCC). Much more needs to be done to shift big money, especially in those regions where new coal power capacities are in the pipeline which have the ability to jeopardize global climate change targets. In this respect, China and other Asian countries are major battlegrounds.

Considering its excellent relationships with some of China's key financial players and its role as the leader in responsible fund asset management in Europe, Luxembourg has the potential to push other financial institutions in China, the world's largest funder of coal power globally, away from coal and toward green energy via green finance. Luxembourg has the channels and ability to reach Chinese institutions in a way that other nations tackling the climate crisis do not. Minister Gramegna seems to recognize this and recently stated that sustainable finance has a larger potential than traditional finance. He also said that he could easily imagine that the Luxembourg Green Bond law could be a trailblazer for China's financial institutions.

As an innovator in green finance, solutions coming from Luxembourg hold great potential for change. A key element of tackling the climate crisis lies in redesigning the financial system to incentivize traditional infrastructure finance players to invest in new forms of infrastructure. For example, Chinese renewable energy investment in Europe and around the world could be mobilized by Luxembourg creating new financial mechanisms to promote an infrastructure investment model that accommodates for the unique project structure that has encumbered renewable energy investments for decades and made projects "too small" or "not bankable".

More generally, Luxembourg could lobby those Chinese banks whose headquarters are located in Luxembourg to use their direct channels with Beijing to promote green finance solutions and to bolster green finance policy in China.

Lastly, in terms of the AIIB, the Bank has a strong credit profile that makes a green bond issuance with Luxembourg a win for both parties and demonstrates AIIB's seriousness about the "green" part of its mantra. Despite this, the Bank had its first bond issuance in London earlier this year, merely assuring that the proceeds will adhere to its weak Environmental and Social Framework. Facilitating a green bond issuance would be an obvious way for Luxembourg to use its expertise to push AIIB money toward green infrastructure.

An unlikely pair, China and Luxembourg should use the opportunity of the AIIB Annual Meeting to begin to set the global stage for enhanced sustainable finance solutions and collaboration. With the help of Luxembourg, China can introduce innovative mechanisms and solutions into its policies and practices and have a channel directly into Europe for its capital flows. With the help of China, Luxembourg can push its influence as a sustainable finance hub far beyond its borders and instill its position as the world's gateway into Europe for sustainable finance.

Minister Gramegna needs to strongly push the message to his peers that the "future of finance will be and has to be green" (quote from Robert Scharfe, CEO of the Luxembourg Stock Exchange). Luxembourg has the ability to play a leading role in bridging the gap between climate ambition and what is actually needed to finance the energy transition in those regions of the world where the future of our climate will be decided, and the way they approach the AIIB Annual Meeting next week could play as a pivotal moment.

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