# Dragoman Digest.

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### Supply chain headwinds loom for Beijing

*Increased scrutiny of Chinese labour practices coming from multiple directions*

Concerns over labour and human rights abuses in **China**'s Xinjiang province are increasingly becoming a concern for multinationals and Chinese authorities and companies, albeit for different reasons. In March, shareholder pressure forced Western companies including Nike and H&M to suspend or curtail their procurement from Xinjiang. Governments are now following shareholders. On July 14, the **US** Senate unanimously passed a law that, if enacted by the House, will effectively ban the import of all goods from Xinjiang.

More surprisingly given **Germany**'s reluctance to rock the boat with Beijing, was the wide-ranging law on supply chain responsibility passed by the Bundestag in early July. As of 2023, German multinationals with over 3,000 employees will have to monitor, assess, and report on their global supply chains. The law itself guarantees the right to form unions and prohibits forced and child labour, with non-compliance fines of up to two percent of a company's annual revenue. The new laws will apply to an impressive array of German multinationals doing business in Xinjiang, including BMW, Siemens, Bosch, Volkswagen, BASF, and Adidas. It is unclear at this stage how the unions clause of the law will be implemented in practice. Prima facie, this provision will cause major issues for any German firm operating anywhere in China, where independent trade unions are banned.

Given Germany's clout and the concerns of other European countries, these laws may well form the basis of an EU-wide standard. Reports suggesting that Chinese suppliers of Nike and Apple are avoiding procurement from sources involving Uyghur forced labour are an early sign of impact.

### US and allies up the ante in calling out Chinese cyber attacks

*Cyber-attacks are emerging as an increasing point of tension in great power relations*

On Monday, the **US** took the relatively unusual step of directly attributing a series of high-profile cyber-attacks to **China**. In keeping with President **Biden**'s efforts to reinvigorate alliances and multilateralism, the US was joined by **Japan**, all NATO nations and Five Eyes partners, the **UK**, **Australia** and **New Zealand**. Washington and its allies accused Beijing's Ministry of State Security of colluding with criminal gangs to orchestrate cyber-attacks like the one earlier this year on Microsoft which affected tens of thousands of companies. The primary intent of the attacks, many of which involved ransomware, seems to have been to steal intellectual property and defence secrets, as well as to probe for further vulnerabilities. The use of criminal elements is intended, however unconvincingly, to give Beijing 'plausible deniability'.

Washington's decision to forcibly call out Beijing is a further sign of the Biden Administration's growing concern over ransomware attacks. Until now, most of these attacks have been blamed on criminal groups operating in **Russia**, likely under the aegis of the Kremlin. After attacks on companies including JBS and Colonial Pipeline, Biden used his bilateral summit with President **Putin** to lay out a clear set of "red lines" on cyber. In both the Russian and Chinese cases, it remains to be seen what actions, if any, will be taken if Beijing and Moscow refuse to reign in their attacks.

## Japan cuts planned use of LNG in power mix

*Australia, Malaysia, Qatar and Russia all stand to lose from the proposed legislation*

Liquified natural gas (LNG) will play a proportionately smaller role in **Japan**'s energy mix under its revised energy-mix targets. On Wednesday, the Ministry of Economy, Trade and Industry (METI) doubled its 2030 renewable energy target. Japan will now look to generate 36-38 percent of its power from renewable sources by 2030, up from the 22-24 percent target set in 2015. The increases are planned to come primarily at the expense of LNG and coal. LNG is now set to account for 20 percent of Japan's power mix in 2030, down from 37 percent in 2019. The plan is in line with Japan's efforts to reduce its carbon emissions by 46 percent on 2013 levels by 2030 and reach net zero emissions by 2050.

Japan accounts for over 20 percent of global LNG demand. Its major sources including **Australia**, **Malaysia**, **Qatar**, and **Russia** are set to be affected if the plan is approved. Whilst China last month overtook Japan as Australia's largest export market for LNG – constituting 39 percent of Australia's export volume over the last financial year against Japan's 37 percent – Japan has traditionally been the biggest buyer of Australian LNG. In 2020, AU$21 billion of LNG was exported from Australia to Japan.

However, the viability of the Japanese plan remains uncertain. It hinges on the installation of substantial renewable capacity – subject to grid connection and land challenges – and overcoming opposition to nuclear power. Based on approximately 14 and 25 percent average capacity factor, Japan's new targets require an increase to solar capacity of 48 GW and a 16 GW increase of wind capacity by 2030. To reach its 20-22 percent nuclear target by 2030, Japan would need to restart 27 nuclear reactors. Only 10 reactors are in operation – down from 54 prior to the Fukushima disaster. In the short-term, these implementation challenges may soften the blow to LNG exporters.

**2030 Strategic Energy Plan proposed by Japan's Ministry of Economy, Trade and Industry**

| Energy | FY2030 (proposed plan) | FY2030 (plan set in 2015) | FY2019 |
|---|---|---|---|
| Renewables | 36%-38% | 22%-24% | 18% |
| LNG | 20% | 27% | 37% |
| Coal | 19% | 26% | 32% |
| Oil | 2% | 3% | 7% |
| Nuclear | 20%-22% | 20%-22% | 6% |
| Hydrogen/Ammonia | 1% | 0% | 0% |

**Source:** Ministry of Economy, Trade and Industry (July 2021)

## China launches national emissions trading scheme

*It will be some time before the scheme has real teeth*

After years of regional trials, **China** has launched a national emissions trading scheme (ETS). On the first day of trading last Friday, a total of 160,000 tons were traded, with the first ton attracting a price of 53 yuan (US$8.2). At this stage, the scheme's coverage is

limited to just over 2,000 companies in the power sector. Still, owing to China's sheer size, China's ETS is already the world's largest.

As well as being limited to the power sector, China's ETS does not have an absolute cap on emissions. It is also unclear how power companies will share the cost of buying carbon credits, as energy prices in China are not market-driven and the government has discretion in setting prices.

However, an absolute cap will most probably be introduced in the next few years. The cement, aluminium and steel sectors are likely to be added next year, with petrochemicals, nonferrous metals and aviation to follow over the next three to five years. After years of dithering, the realisation of China's national ETS is another sure sign of Beijing's increasingly serious intent to decarbonise its economy.