Dragoman Digest

Coal-dependent economies face politically fraught energy transition

Poland's path to decarbonisation hinges on ability to secure a just transition for coal industry

Coal-reliant economies – including **Poland**, **Australia** and **Indonesia** – face similar challenges in managing the energy transition and meeting ambitious emissions reduction targets. Poland has committed to achieving the **EU** target to reduce carbon emissions by 55 percent by 2030 on 1990 levels, reaching carbon neutrality by 2050. The most material challenge faced by Poland is managing the phase-out of coal power plants amidst sensitivity to energy price increases and resistance from coal-mining regions. Poland plans to reduce the share of coal in its energy mix from around 72 percent to 37-56 percent by 2030, and as low as 11 percent by 2040. The Polish Government plans to nationalise and gradually wind down 70 of the country's nearly 150 coal plants. Most plants will be phased out by 2049. Warsaw is planning to use subsidies to stave off increases to household electricity bills and transition 80,000 coal miners to new industries like hydrogen and gas, though these funds are yet to be approved by the EU.

However, Poland's plan is not rapid enough. Its five largest coal power plants are projected to become uneconomic as early as 2024 – far earlier than planned closure dates – due to measures such as the rising cost of carbon permits under the EU's emissions trading scheme. The coal plants that are not covered by the Government's nationalisation plan will require subsidies to guarantee the stability of the grid and electricity prices.

The feasibility of nuclear – slated to play a key role in guaranteeing energy stability in the absence of coal – is also uncertain. By 2040, nuclear power is set to account for 16 percent of Poland's energy mix. Although the construction of the first nuclear unit is slated to begin in 2024, a site is yet to be chosen. The plan has been met with resistance from locals in areas being examined as potential reactor sites. An additional five 1-1.6 gigawatt nuclear reactions will be need to built every two years, five years faster than the average construction lead time for nuclear reactors.

Phase-out date for largest coal power plants in Poland

Coal plant	Capacity (megawatt)	Planned retirement	Uneconomic by
Bełchatów	4928 MW	2030-2036	2027
Kozienice	3915 MW	2049	2025
Opole	3280 MW	2049	2025
Jaworzno 3	2255 MW	2049	2025
Turów	1765 MW	2049	2024

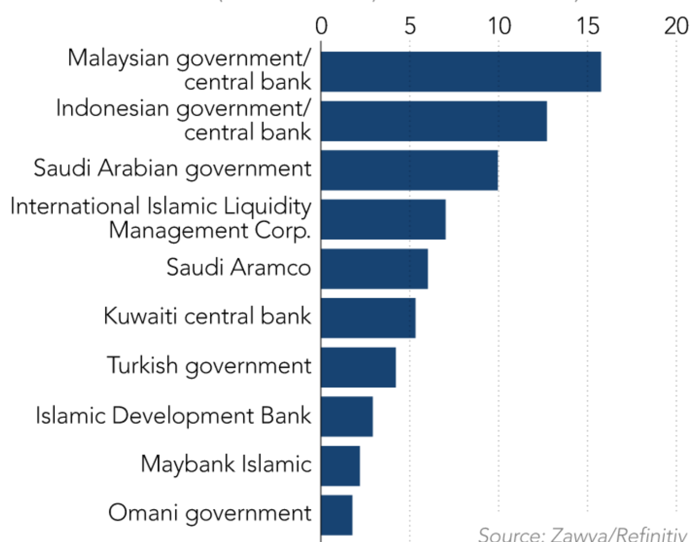
Source: Climate Analytics, Global Coal Plant Tracker – Global Energy Monitor

Garuda Indonesia defaults on Sharia-compliant debt

Resolution may set a precedent for future defaults in Indonesia

The use of Sharia-compliant Islamic bonds, known as *sukuk*, has increased sharply as a means for governments and companies to finance stimulus packages and raise capital in the wake of COVID-19 induced downturns. Last year, total global *sukuk* issuances increased by over 19 percent to US$174 billion. Saudi Aramco raised US$6 billion in June, marking the largest ever corporate *sukuk*. This year, total global issuance is expected to a hit a record of around US$180 billion. Despite their growing popularity, there is no standardised global legal or regulatory framework for enforcing contractual rights if a default occurs. The default of Indonesian airline Garuda Indonesia in late June on its US$500 million sukuk has raised the profile of the financial instrument.

The court mechanisms for resolving Islamic financial disputes differ between jurisdictions. When **UAE** energy company Dana Gas defaulted on a US$700 million *sukuk* bond in 2017 a **UK** court ruled that its debt obligations were binding. Conversely, a UAE court ruled the bond was not Sharia-compliant meaning Dana Gas was not obliged to pay. Indonesia's resolution mechanisms are far less developed than its counterparts such as **Malaysia**, where *sukuk* bonds represent 60 percent of the country's debt markets. Under Indonesian law, religious courts have the authority to resolve Islamic financial disputes, though it is more likely that the dispute will be settled in a commercial court. The resolution of Garuda's default will likely set the precedent for future defaults. Notably, Indonesian state-owned construction company PT Indah Karya and property developer PT Prima Jaringan missed smaller period payments last year. More companies are expected to be at risk of default as Indonesia's economic recovery is set to suffer a major setback next quarter as the COVID-19 situation deteriorates.



Dilemmas facing the EU's CBAM

Delicate balancing act required

In mid-July, the European Commission unveiled its ambitious "Fit for 55" climate package. Targets include reducing emissions by 55 percent from 1990 levels by 2030 and a de facto ban on the sales of new non-EV vehicles by 2035. The package also includes a proposal for

the institution of a carbon border adjustment mechanism (CBAM) by 2023 covering steel, aluminium, cement, electricity, and fertilizer.

The CBAM is intended to prevent "carbon leakage" to other jurisdictions, either through European companies offshoring production or losing market share to more polluting competitors. Under the CBAM, European importers will pay a levy on non-EU goods that mirrors the price of carbon in the **EU**'s ETS – or the differential between this price and any ETS that exists in the country from where goods are imported. Free allocations – the current practice of granting free carbon permits to carbon intensive European manufacturers – would be gradually phased out by 2036. This would avoid so called "double protection", where EU industries would be protected by both the CBAM and free allocations.

The European Parliament is likely to push back on the issue of free allocations. This is for good reason. Take the example of **Turkish** steelmakers. In the European market, European steelmakers would compete with their Turkish peers on a level playing field. However, until the **US** adopts a CBAM-like measure, the same could not be said for the American market.

The EU is already under concerted pressure from **China**, and to a lesser extent the US, over its CBAM proposal. WTO rules have exemptions for trade measures related to the protection of human life and the conservation of natural resources. To ensure compliance however, the EU will need to ensure that the CBAM is packaged as a climate rather than trade protection measure. Hence the European Commission's balancing act. Expect plenty of horse-trading as the EU Parliament moves to consider the Fit for 55 agenda.

Beijing enacts further measures to bring big tech to heel

The era of freewheeling tech is over

Last week, China's Central Committee and State Council released a five-year plan to strengthen control over sectors including technology, education and healthcare. This came hot on the heels of regulations that effectively sounded the death knell for several large private education companies in the US$100 billion after-school tutoring industry.

Though light on specific detail, the five-year plan paves the way for further wide-reaching regulations. The plan cites an "urgent need" for more legislation to govern key sectors, resolve anti-competition issues and ensure that "new business models develop in a healthy manner". Meeting the "people's growing need for a better life" is also an additional theme of the plan. In a separate move, Beijing also raised the R&D spending requirements for tech companies to qualify for lucrative tax breaks.

The combined intent of these measures is to re-fashion big tech into a force multiplier for Beijing's policy objectives. Competing with SOEs, pursuing overseas IPOs without express permission, engaging in monopolistic practices and pursuing profit at the expense of social and financial stability will ideally (at least from Beijing's perspective) be a thing of the past. Instead, big tech will pursue innovation in areas of strategic and social importance for Beijing. It remains to be seen what impact this ambitious and disruptive approach will have on growth and foreign investment.

Biden considers Africa trade and engagement strategy

So far, allocated dollar figures look to be relatively small fry

In late July, President **Joe Biden** revived former President Trump's "Prosper Africa' initiative. Biden requested US$80 million from Congress to help fund the "Prosper Africa Build Together Campaign" that aims to increase bilateral trade and development assistance across priority sectors including energy, climate, health, and digital technology. The **US** Development Finance Corporation (DFC) is expected to play a significant role. This year, the DFC

has provided US$2 billion in funding for projects in Africa and is expected to provide at least another US$500 million by year end.

Africa hands have also been pushing the Administration to engage with the African Continental Free Trade Area (AfCFTA). The world's largest free trade agreement by number of countries involved, AfCFTA will gradually create a single market across most of the African continent. Though the US could not formally join AfCFTA, experts argue that the US should nonetheless support the new trade bloc which unlike the CPTPP, does not have pre-existing negative connotations in Washington. For its part, the **EU** is working to support the implementation of AfCFTA, with the eventual, long-term intent being to sign a continent-to-continent free trade deal. With the previous elite consensus on free trade gone, there is a risk that Biden Administration simply doesn't have time for such a long-term game.