Dragoman Digest

Financial institutions devise plan to accelerate the retirement of Asia's coal fleets

The model might present an opportunity to manage exit from coal in an equitable way

A consortium of financial institutions will propose a model at the UN's COP26 climate conference in November to accelerate the retirement of coal-fired power plants in low and lower-middle income countries. Partners include the Asian Development Bank, **UK** insurer Prudential, Citigroup Inc., BlackRock Inc and HSBC Holdings Plc. Coal plants in **Indonesia**, **Vietnam** and the **Philippines** – which all have sizeable construction pipelines – are initial priorities.

Two separate mechanisms – both overseen and managed by a multilateral bank (such as the ADB) – have been proposed. A "carbon retirement mechanism" funded by global financial institutions would purchase coal plants from current owners and retire them over 10-15 years, instead of the average lifetime of 30-40 years. Investors would receive 5 percent returns. The original owners will be incentivised to invest the capital into renewable energy sources. Theoretically, phasing out coal plants over 10-15 years will give countries time to transition to renewable energy and manage energy security. A parallel "sustainable energy transition mechanism" will deliver technical expertise, re-training and additional financing for renewables. The responsibility for decommissioning or transitioning coal assets has not yet been decided.

Much will hinge on the proposal's ability to attract financing at COP26. Modelling suggests that retiring 50 percent of Indonesia, Vietnam, and the Philippines coal-fired capacity (assuming a cost of US$1-1.8 million per megawatt) would require US$30-55 billion in funding. The mechanisms would also rely on binding agreements with the host government to commit to the terms of coal plant retirement programmes. It is also unclear at this stage how political factors – such vested coal interests and sensitivities around foreign ownership of infrastructure – would be negotiated.

Largest planned coal-fired capacity increases amongst low-income and lower-middle income countries in Asia

Country	Current coal-fired capacity (MW)	Pre-construction pipeline (MW) (Announced, pre-permit, permitted)	Construction pipeline (MW)	Current + pipeline coal-fired capacity (MW)
India	233,077	20,708	34,405	288,190
Indonesia	36,652	18,425	11,839	66,916
Vietnam	20,917	19,360	8,640	48,917
Bangladesh	1,845	10,190	4,094	16,129
Philippines	10,557	3,365	1,621	15,543
Pakistan	4,938	4,105	3,300	12,343

Source: Global Energy Monitor Global Coal Plant Tracker (July 2021)

Former Pentagon official nominated as Biden's pick for key technology control position

Previously obscure bureaucratic posting emerges as focal point in Sino-US tech competition

In mid-July, **US** President **Joe Biden** tapped former Pentagon official Alan Estevez to serve as the US Commerce Department's undersecretary for industry and security. The Bureau of Industry and Security (BIS) post oversees the US "entity list", or trade blacklist. The Biden Administration has continued to put Chinese companies (especially those with strong military ties) on the list, adding 14 companies last month over accusations of being complicit or actively involved in human rights abuses in Xinjiang. Measures enacted by BIS have played a key role in crippling Huawei.

Estevez's appointment is unlikely to presage a change of direction in the US' approach. Though Estevez does not have an extensive public record of making strong statements on China, his credentials are suitably hawkish. Before his current role at Deloitte, Estevez had a 36-year-career at the Department of Defense. Under the Obama Administration, Estevez represented the DoD on the Committee on Foreign Investment in the United States. In case there was any doubt, the Administration's public messaging has framed Estevez's appointment as in keeping with the objective of bolstering "export control and investment screening efforts".

Assuming he is confirmed by the Senate, Estevez will still have to strike a careful balance between national security and commercial imperatives. The Chinese market is an important source of R&D revenue for many US tech companies. Export controls that are not appropriately targeted risk being self-defeating by harming US innovation efforts.

Bank of Korea adjusts forward guidance

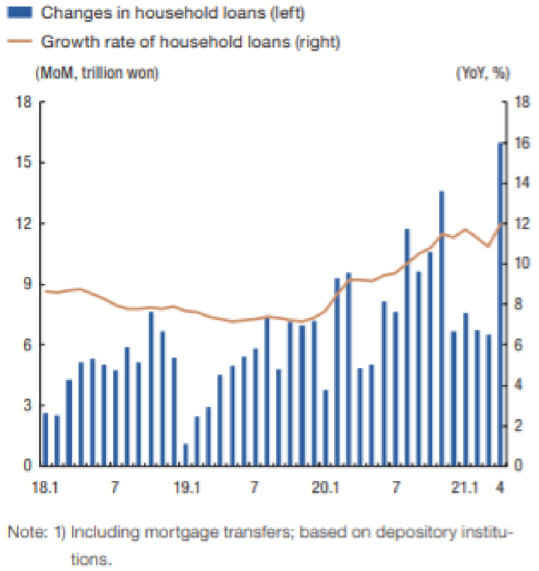
Rising household debt and asset prices carry clear political risks for President Moon Jae-in

The Bank of Korea (BoK) has adjusted its forward guidance on interest rates to control rising household debt and asset bubbles. The BoK is now forecasting an interest rate increase this month instead of October. Rates have been held at 0.5 percent since May last year. A rate hike would make the BoK the first central bank in Asia to begin normalising monetary policy after COVID-19 stimulatory measures.

The possible hike in interest rates comes after President **Moon Jae-in** failed to deliver on his pledge to make housing more affordable. Since Moon's election in 2017, apartment prices in Seoul have increased by around 60-70 percent. Supply-side policies, including reducing red tape around development and raising height restrictions in apartments in Seoul have a long lead time and have yet to make a dent in housing prices. Household debt and real-estate prices are closely linked. Household debt has increased by 10 percent year-on-year to around 103 percent of GDP – far above Asia's average of around 60 percent. The average household debt is equivalent to 171 percent of annual income. Over 80 percent of wealth is invested in real-estate, largely under *Jeonse* schemes where instead of paying monthly rent, tenants are required to advance roughly 70 percent of the property's value as a deposit to the landlord – usually paid by taking out a loan.

Compounding matters for Moon, has been the involvement of several government officials in a property speculation scheme using inside information. Moon's presidential term will expire next year. Housing affordability and household debt are firming as key issues for Moon's Democratic Party in advance of next year's election.

Household loans in South Korea



Source: Bank of Korea

No immediate end in sight for global chip shortages

Trade-offs emerge between innovation and self-sufficiency

Global companies continue to be hobbled by chip shortages. According to analysis from Goldman Sachs, 169 industries in the **US** are in some way impacted by the supply shortage. Automakers are particularly hard hit. Volkswagen, Ford, and Nissan have all been forced to make production cuts. **Chinese** players are suffering too, with Changan reporting an approximately 30 percent shortfall in integrated circuits during Q1 this year. The China Association of Automobile Manufactures expects shortages to persist until at least early 2022.

No one factor explains the current shortage. Semiconductor manufacturers failed to anticipate that demand would recovery as quickly as it did. When demand surged in the second half of 2020, chipmakers were consequently unable to match supply with a deluge of orders. Separately, the US campaign against Huawei incentivised the tech company to stockpile chips. In turn, this encouraged other Chinese companies to build their own stockpiles to try and win market share from Huawei. Another factor is market concentration. **Taiwan** and **South Korea** (principally TSMC and Samsung) dominate semiconductor manufacturing and have prioritised supplying local companies.

To protect their own industries from future bottlenecks, the response of various national governments has been to pursue semiconductor self-sufficiency. President **Biden's** Innovation and Competition Act promises US$52 billion towards semiconductor manufacturing and R&D. The **EU** is exploring putting an unspecified amount of public money towards the objective of doubling its share of the global chip market by 2030.

Though global crises like COVID19 – or perhaps a future Taiwan conflagration – illustrate the shortcomings of the current state of the semiconductor market, self-sufficiency is no panacea. Despite well over US$100 billion in subsidies since 2011, China is not projected to reach 20 percent self-sufficiency by 2025. This is light years away from the 70 percent target set under the Made in China 2025 policy. Rather than attempting to create local champions, attracting TSMC and Samsung to set up shop may be a more realistic policy objective.

Shenzhen looks to roll-back key anti-corruption measures

Proposed policy will not make things any easier for China's private sector

Lawmakers in the **Chinese** city of Shenzhen are considering regulations that would allow leading Party officials to take up part-time roles at SOEs. Specifically, officials would be able to serve as directors or supervisors of SOEs without receiving any formal salaries or bonuses. Officials would be able to serve based on the proviso that they would refrain from using their influence to seek illicit gains for the companies in question.

If enacted, this package of measures would reverse reforms introduced in 2013 by the central government which banned the practice of leading party officials serving as directors of SOEs. Intended to prevent corruption and promote fair competition, Beijing's reforms led to 40,700 leading party and government cadres leaving their part-time positions at SOEs.

As a special economic zone and pioneer of market reforms, Shenzhen has special autonomy to test-drive innovative new policies. Often, policies first rolled-out in Shenzhen are eventually implemented nationwide. Shenzhen, for example, has been at the forefront of digital currency and carbon trading-related policy innovations. The proposal to reverse the centre's 2013 reforms is unlikely to have been proposed without Beijing's consent and direction. It also clearly goes against the grain of Shenzhen's traditional entrepreneurial policy ethos.