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The politics of China's debt crises

Opportunities to strike blows against rivals may underpin some of Xi's calculus in dealing with spiralling debt

Chinese companies' debts appear increasingly unsustainable. In the first half of 2021, defaults on corporate bonds reached a high of US$9.67 billion. State owned enterprises (SOEs) contributed to more than half of these defaults. The rise in defaults signals a gradual retreat from the implicit guarantee that the Government would always bail out SOEs. With many companies putting their hand up for help from state-controlled financial institutions, there is evidence to suggest that political motivations may contribute to the Government's financial decisions.

A key example of the influence of internal party politics in financial decision-making is Evergrande. The Party's restrained response to dealing with Evergrande – in comparison to its decisive action with past economic crises – could be influenced by Xi's clash with founder and chairman Xu Jiayin. Xu is believed to have close to ties to the Communist Youth League Faction, a political party largely side-lined under Xi. Evergrande's base is in Guangdong – the home of the Youth League – and many believe that the League helped move the developer's listing forwards, contributing to its growth. The League now has almost no party representation. Premier Li Keqiang – who has roots with the Youth League – is considered the closest thing Xi has to a rival, after he vied with Xi for the Communist Party's top post. Xi has previously moved to consolidate his influence in Guangdong, pushing out League members and installing close ally Li Xi into the province's top party post.

Whilst there are economic reasons motivating the party's reluctance to bail out Evergrande (namely the need to reduce debt burdens and instil more financial discipline in the economy), internal political machinations may also be contributing to the Party's reluctance to bail-out Evergrande. Instead of protecting the wealth of Xu, the Party's main priority is on protecting homeowners and possibly domestic bondholders.

China launches intellectual property offensive

Foreign businesses face more IP lawsuits filed by emboldened Chinese companies

China's enhanced intellectual property (IP) legislation has led to a growing number of IP lawsuits filed by Chinese companies against foreign businesses.

Foreign companies have long complained about IP theft by Chinese companies. Now, the growing amount of IP owned by Chinese businesses and the Chinese Communist Party's (CCP's) revised IP legislation, has led to a tripling of IP-related lawsuits filed in China from 2016 to 2020. Chinese companies are increasingly producing their own innovations, with firms filing their own patents.

In recent years, China has taken a variety of steps designed to protect its IP. China made IP protection a priority in its Five-Year Plan (2021-2025), part of its strategy to pursue technological self-reliance and a more innovative economy. In line with the phase one trade deal signed with the **US** in 2020, China revised its trademark, patent and copyright laws. China introduced punitive damages in addition to actual damages and reduced the burden of proof for plaintiffs in patent infringement cases.

Foreign companies now have to readjust their strategies to focus both on protecting IP and dealing with claims of IP infringement by Chinese companies. For instance, **Japanese** companies have had to learn to make swift responses to actions taken by plaintiffs. Tokyo-based company Ryohin Keikaku battled with Beijing Cottonfield Textile Corp for two and a half years on IP charges and is still involved in more than ten legal disputes over Muji's use of Chinese characters in many of its products.

The rise of IP lawsuits is emblematic of the changing business climate in China, as it seeks to move up the value chain and become more innovative. As Chinese companies continue to promote innovation in technology – particularly 5G and artificial intelligence – there will likely be a rise of lawsuits concerning critical technologies and Chinese patents.

South Korea set to curb big tech's app-store dominance

South Korean legislation part of global push to better regulate big-tech

South Korea passed an amendment last month that prevents app-storeowners from requiring developers to use in-house payment systems. The first of its kind, the legislation will be a blow to major platform owners Google and Apple, which control more than 85 percent of the app market in South Korea.

Currently, Apple and Google require developers to pay a commission as high as 30 percent for every transaction in the app store. Google and Apple removed Fortnite from their app stores last year, after its creator – Epic Games – attempted to bypass the 30 percent fee the companies charge developers. Now, Google and Apple will be required to open their app stores to competing payment systems, banning operators from delaying the approval of apps or deleting them.

South Korea's new legislation is part of the broader global trend cracking down on big tech. Washington lawmakers – who favour tech regulation – have already hailed South Korea's move to curb tech dominance and urged passage of a similar proposal – termed the Open App Markets Act. The **EU** proposed the Digital Markets Act in December last year, which aims to prevent platforms from abusing their gatekeeper position. **Australia** is also considering tightening the regulation of digital payment services by Apple and Google. A recent Australian Competition and Consumer Commission report asked for new powers to rein in Google's dominance in the ad tech market after finding that 90 per cent of ads passed through at least one Google service.

ESG regulations in the US and EU diverge

The US and EU have missed an opportunity to take a coordinated approach to regulating ESG disclosures

The **US** Securities and Exchange Commissions (SEC) announced its focus on tackling "green washing" in July this year, in response to President Joe **Biden's** executive order on climate related financial risk disclosure.

The SEC is set to target publicly listed companies, with reforms calling on them to provide mandatory qualitative and quantitative disclosures on climate change risk management to investors. Disclosures will need to provide information such as metrics related to greenhouse gas emissions, financial impacts of climate change and the companies' progress towards climate-related goals. The SEC plans to release a full set of climate-related disclosure requirements for companies in December.

The **EU** on the other hand, has taken a broader approach towards regulating corporate sustainability, covering large unlisted firms as well as publicly listed companies. Earlier this year, the EU set up the Corporate Sustainability Reporting Directive (CSRD). The CSRD proposal – set to come into effect in 2023 – requires companies to report their sustainability performance using EU-wide disclosure standards. Companies will need to disclose the extent to which their activities are compatible with the goal of limiting global warming to 1.5 degrees Celsius, promoting greater corporate transparency in European capital markets.

This is not the first time the US and EU have differed on measures related to ESG. Last month, the US was unwilling to follow the EU's lead on its Carbon Border Adjustment Mechanism, wary of the supply chain and trade impacts a carbon levy could have on US imports into the EU.

A lack of coordination by the US and EU on disclosure standards does not bode well for the prospects of globally consistent ESG regulation. Different regulatory regimes will become a source of complexity for companies operating across jurisdictions.

Climate change as a security risk in the UNSC

UNSC debates whether climate change should be included as a security issue in the Security Council

At the United Nations General Assembly (UNGA) meeting in New York last week, the United Nations Security Council (UNSC) convened on the side-lines to debate how best to address the intersection of climate change and global security.

Whilst all delegates at the UNSC agreed on the necessity of curbing emissions, there were divergent views on what role the Security Council should play. Most countries were in support of including climate change in the Council's work to some degree. **Niger**, **Kenya** and the **US** were strong proponents of its inclusion, with Niger's Deputy Prime Minister claiming that water scarcity has been driving conflict and hampering efforts to build peace. Only **Russia**, **China**, and to a lesser extent **India** were opposed. Russia and China stated specialised formats – such as the UN Framework Convention on Climate Change and the Paris Agreement – were responsible for handling climate change.

If climate change were included in the UNSC's role, the Council's reach would extend to multiple new jurisdictions. According to a Security Council Report, likely actions the Council would take could include sanctioning large emitters – both states and entities

– or blocking the imports or exports of a particularly harmful product. The Council could also expand peacebuilding efforts to include capacity building in renewables or other technologies deemed to be stabilising, addressing water scarcity in places like Niger.

However, with China and Russia in opposition, it will be difficult to categorise climate change as a security issue. Even with majority support, the council is still trying to understand and define the nature of the climate crisis. Identifying measured and coordinated approaches for the council to take will require substantial resources and funding. In this regard, the Security Council would not be inspired by the failure of developed countries to mobilise the US$100 billion target set under the Paris Agreement.