Dragoman Digest

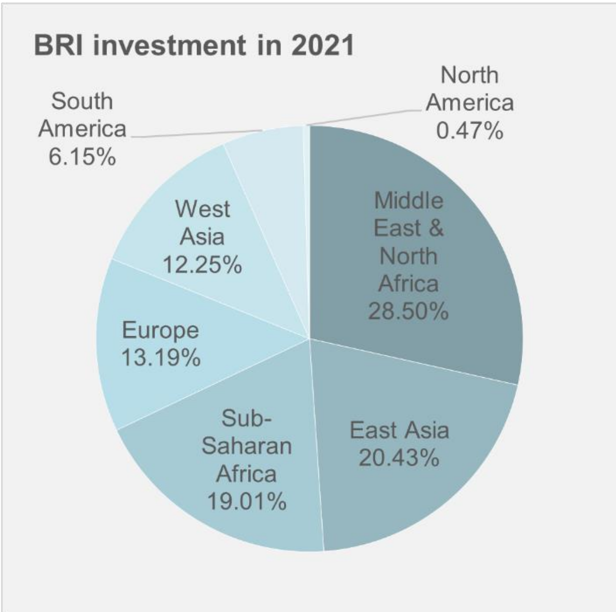
China pivots toward Middle East and Africa

Shift driven by a desire for secure, diversified energy

China is ramping up investment in the Middle East and Africa in a bid to secure future energy sources. Last year, nearly half of Beijing's Belt and Road Initiative (BRI) investments were made in the regions – close to US$30 billion. Its investments were focused on energy and transport infrastructure. This represents a notable increase from 2020, where it attracted 12 percent of BRI funding compared with Asia's 72 percent.

Iraq attracted more investment than any other nation, with around US$10.5 billion committed to finance construction projects. Significant projects include Al-Khairat, a 3.2-gigawatt oil-fired power plant in southern Iraq and the 600 MMcf/d Mansuriya gas field near the Iranian border, both of which are being developed by Chinese companies. Last year, China agreed to invest US$400 billion over 25 years in Iranian infrastructure in exchange for a steady supply of discounted oil.

Beijing's efforts to deepen its engagement across the Middle East are motivated, in part, by a commitment to bolstering domestic energy security. It is highly reliant on the region for its energy needs. 50 percent of China's crude oil imports come from the Middle East and Qatar alone accounts for 20 percent of its total liquified natural gas imports. China's energy crisis in 2021 – driven by coal shortages and fixed electricity pricing – is likely to be reinforcing Beijing's focus on securing China's energy supply.



Source: China Belt and Road Initiative Investment Report, Green Finance and Development Centre, 2021

Electricity market reform in Mexico

Reform would likely deter private sector investment required to meet clean energy goals

President **Andrés Manuel López Obrador's** (AMLO) flagship legislative package to bring energy further under state control is under consideration in Congress. If passed, it will likely slow progress toward achieving a low-carbon grid by deterring private sector investment. An additional US$10 billion of investment in new wind and solar capacity is estimated to be required to meet Mexico's pledge of achieving 35 percent clean energy by 2024, up from around 24 percent today. A decision on the package is set to be made in the coming weeks.

Under AMLO's proposal, the state-owned electricity utility, Federal Electricity Commission (CFE), will increase its market share by nearly 15 points to over 50 percent. Private sector market share would be limited to 46 percent. Energy generated by the CFE – largely derived from fossil fuels – would be prioritised for dispatch, regardless of marginal cost. Some electricity-generation permits granted to foreign operators would also be cancelled, threatening up to US$22 billion – or around 15 GW – of renewable energy projects. Foreign operators allowed to continue would be required to sell electricity to CFE at a price set by the utility.

While AMLO's Movement of National Regeneration (MORENA) party currently lacks the two-thirds majority required to approve the reform, one major opposition party has indicated it is open to supporting some elements of the package. Even if the legislation isn't passed in its entirety, it appears to have already played some part in deterring finance, with investment in renewable energy projects falling nearly 50 percent last year to around US$1 billion.

EU announces massive chip investment plan

Quest for self-reliance risks inefficiencies and tariff war

The EU has entered the global semiconductor chip race. It has announced a €43 billion investment plan to aid its aim to double the EU's share of the global semiconductor market from 10 to 20 percent by 2030, equivalent to a quadrupling of chip output. Under the plan, the European Commission will pool €11 billion to build three pilot fabrication facilities for any company to use. Businesses are expected to invest an additional €32 billion by 2030.

Recent global supply chain shortages and concerns about containing China's technological dominance in certain technologies is driving the EU – and various national governments including South Korea, the US and China – to pursue a heightened level of "technological sovereignty." But investment inefficiency is a key risk in massive public investment plans. Some analysts believe targeted investment in areas the EU already has competitive advantage such as research and specialist manufacturing would deliver more strategic value than in large manufacturing plants. Dutch multinational ASML for example, is the only supplier of the extreme ultraviolet lithography machines required to manufacture the most advanced semiconductors in the world. Others have pointed out that the EU is unlikely to be able to compete with economies with lower labour costs like Thailand, Indonesia and India.

The EU will also have new powers to restrict semiconductor exports or apply sanctions if supply is threatened. Without a multilateral export control regime with the EU's partners however, this may result in retaliation that worsens global shortages.

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Vietnam introduces first private sector pension fund

Deeper reform may be required to counter ‘grey tide’

Vietnam has introduced its first private sector pension fund as its demographic transition looms. By 2035, the country is expected become an ‘aged’ society, with 20 percent of its 98 million population over working age, making it one of the fastest-ageing countries in the world.

Dragon Capital VietFund Management’s investment vehicle offers three fund options from relatively high risk to conservative. Savings can be withdrawn upon reaching retirement age – which was raised by early last year to 62 for men and 60 for women. It will increase by three months for men and four months for women each year to 2035. While the opening of the state-dominated sector has been welcomed, as well as the phased lifting of the retirement age, some say broader reform is required to avoid a massive pension short fall in the next decade.

According to the World Bank, just 25 percent of Vietnam’s labour force is covered by the country’s voluntary and social pension schemes – with no safety net for informal workers. The Government’s pension provisions will not meet annual claims on them, becoming cash-flow negative between 2028 and 2034. As a result, accumulated reserves will be run down between 2036 and 2042, and so bring rising pension claims on the national budget. On top, the non-pension needs of an ageing society is forecast to add 5 percent of GDP in additional expenditure. Unless Vietnam can reform its pension system and prepare for the rising cost of caring for a rapidly growing elderly population, its future economic growth is likely to be challenged.