

Dragoman Digest

Biden signs landmark bill with a range of subsidies for electric vehicles

Whether the Bill will help or hinder EV uptake is uncertain

On August 16, President **Joe Biden** signed into law the Inflation Reduction Act (IRA). It mobilises approximately US\$370 billion to foster clean energy development and combat climate change. The bill attempts to use tax credits to keep electric vehicles (EV) affordable while simultaneously incentivising the development of supply chains less dependent on **China**. The IRA contains provisions for tax credits worth up to US\$7,500 for buyers of EV and hybrid plug-ins through to 2032. To qualify, vehicles must now be assembled in North America. Further – 40 percent of battery metal must be extracted or processed in the US or a country with which the US has a free trade agreement or sourced from material recycled in North America. This will be scaled up to 80 percent by 2027. From 2024, the act excludes vehicles if they include content – such as critical minerals – from a “foreign entity of concern” including China and **Russia**.

Ironically, the EV components of the Act emulate Chinese style industrial policy. China’s emergence as one of the world’s largest hubs for EV manufacturing can partially be attributed to its aggressive industrial policy. Currently, Chinese buyers of EVs are entitled to subsidies, but only for Chinese-made vehicles. From 2015-2019, to be eligible for subsidies, the vehicle has to contain a battery made from a list of Chinese battery manufacturers. This excludes non-Chinese battery companies from China’s domestic market, allowing domestic firms to establish a massive market share.

However, in mirroring China’s approach, the US risks slowing domestic EV uptake. Currently, very few vehicles would qualify for the full subsidy. Of those that do, many are more expensive and subsequently may be ineligible because of the price cap of US\$55,000 for Sedans, and US\$80,000 for SUV’s and trucks. It remains to be seen how flexible Congress will be in tweaking subsidies if initial policy objectives prove to be too ambitious.

US solar industry faces delays as Uyghur forced labour restrictions enter force

The new US law will be felt particularly by the solar panel industry

Washington’s crackdown on human-rights abuses in **China** is having unintended consequences. The Uyghur Forced Labor Prevention Act (UFLPA), which went into force in June, assumes that all “goods...manufactured wholly or in-part manufactured in Xinjiang are the product of forced labour”. This is unless proven otherwise by “clear and convincing evidence”. Subsequently, the law places the burden of proof on manufacturers, many of whom are ill-equipped to provide the specific documentation required. Xinjiang is a key hub for solar panel production – holding for example, 41 percent of the world’s manufacturing capacity for polysilicon.

In recent weeks, several Chinese manufacturers including Trina Solar, Longi Green Energy Technology Co, and Jinko Solar have had their shipments to the US turned away as the law begins being enforced. Some solar projects have recorded a 30 to 40 percent rise in the costs of panels. The US is evidently facing a balancing act as it seeks to curb forced labour abuses while still pursuing its own ambitious renewables goals. The US currently has 125 gigawatts of onshore renewable energy operating capacity, and intends to permit at least 25 gigawatts more by 2025. But with nine to 12 gigawatts of solar modules predicted to be detained by the restrictions by year end – the UFLPA may hinder how quickly this goal will be achieved. With supplies from China constrained, there may be opportunities for US based solar manufacturers – eligible for tax credits under the new Inflation Reduction Act – to recover market share.

Tesla reportedly signs contracts to purchase US\$5 billion worth of Indonesian nickel

Though not confirmed by Tesla – the deal has already been scrutinised heavily by NGOs

Indonesia implemented an export ban on unprocessed nickel in January 2020, which has led to over US\$30 billion in mostly foreign investment in downstream processing. In implementing the ban, Jakarta sought to leverage its vast nickel reserves – approximately 24 percent of the global total. This strategy has paid dividends. **Korean** giants LG and Hyundai recently announced over US\$7 billion in battery and EV manufacturing investment in Indonesia. This marks a step up the value chain from previous investments in lower-grade nickel products used in steelmaking and is firmly in line with Indonesia's strategy.

The government has also been actively pursuing Tesla, with President **Joko Widodo** visiting CEO Elon Musk in May. Recent unconfirmed statements from Jakarta's coordinating Minister for Maritime and Investment Affairs, Luhut Pandjaitan, suggest that Tesla has agreed to buy US\$5 billion worth of nickel products from Indonesia over the next 5 years. Tesla has signed five-year contracts with two **Chinese** companies operating at the Morowali industrial park in Central Sulawesi – Zhejiang Huayou Cobalt and CNGR Advanced Material.

Musk pledged in 2020 that Tesla would be seeking ways to extract nickel in an "efficient and environmentally sustainable manner". However, Indonesia's nickel processing is notoriously carbon intensive. All major industrial parks (e.g. Konawe, Morowali and Weda) are powered by captive-coal fired plants. According to the International Energy Agency, producing nickel in Indonesia can be up to six-times as carbon-intensive as producing it in **Canada**. In July, dozens of NGOs sent an open letter to Musk, urging Tesla to terminate any investment plans in Indonesia's nickel industry, citing environmental concerns over pollution, waste and increased deforestation. Whether the deal materialises or not, its reception highlights the difficulty that EV players will have in securing supply chains whilst adhering to ESG- standards.

Foxconn faces fine for latest investment in Chinese chip company

Taiwanese officials are urging Foxconn to unwind the deal to limit Taiwan's reliance on Beijing

Apple supplier Foxconn is being pressured by **Taiwanese** national security officials to undo its US\$796 million investment in **Chinese** chip company Tsinghua Unigroup. Foxconn announced the investment last month, which would make it the second-largest shareholder in Tsinghua with a 10 percent stake. It could now face a fine from the Taiwanese economic ministry for not submitting the transaction for prior approval. Since 2016, Taiwan has been encouraging and actively subsidising companies to re-orientate their operations out of China through its New Southbound Policy. Taiwanese companies are required to seek approval by the Investment Commission to invest in critical technologies in China. Foxconn company executives have argued that the investment is above board as Tsinghua Unigroup no longer has chipmaking capabilities since its restructuring was finalised in July.

Investments in the Chinese market are potentially highly lucrative for Foxconn, which wants to deepen its investments in semiconductors. It could also be argued that Foxconn becoming a major shareholder in a Chinese chip-making company could induce a beneficial element of mutual dependence. Foxconn appears to have no easy options. It is exploring alternatives, having signed a joint venture in May with **Malaysia** to build a fabrication plant. It is exploring similar opportunities in **India**. Neither market, however, has China's scale. Taiwan is grappling with the difficult question of how to achieve a balance between growth and national security when engaging with China.

Berlin looks to new Asian markets to diversify away from China

Gone are the days of gently raising human rights grievances while pushing full steam ahead with business ties

Germany is consciously, if not belatedly, attempting to reduce its reliance on **China**. Beijing has been Germany's largest trading partner for the past six years, with Berlin exporting US\$112 billion worth of goods in 2020. Berlin also relies on China for key raw materials and has other dependencies including electric vehicles, wind turbines, and solar panels. Germany, long believed in a '*wandel durch handel*' or 'change through trade', the notion that trade links would foster positive political change. This position has been dealt a blow by **Russia's** invasion of **Ukraine**. Multiple other factors including human rights abuses in Xinjiang, and the growing risk of conflict over **Taiwan** have engendered a much more critical view of China. In July 2021, after passing its own Supply Chain Due Diligence Act, Germany took the unprecedented step of declining a Volkswagen request to renew risk insurance for the company's Chinese operations citing human rights concerns. Volkswagen's operations in Xinjiang have long been a target of scrutiny.

As these factors compound, German industry leaders are increasingly looking to alternative Asian markets. These efforts have manifested in a major Asian-German business conference to be held in November in **Singapore**. As the EU's largest economy, Germany's desire for markets will almost certainly add impetus to current EU efforts to develop free trade agreements with **India** and **Indonesia** respectively. Ultimately, however, the cost of decoupling and Germany having lost access to the Russian export market will significantly constrain any pivot away from China.