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Dragoman Digest

G7 to diversify critical minerals mines and supply chains

Builds on material steps undertaken by individual countries

Last week, G7 economies agreed on measures to diversify critical mineral supply chains, given concerns over **China**'s dominance. Specifically, relevant ministers from the **US**, **UK**, **Canada**, **France**, **Germany**, **Italy,** and **Japan** proposed the *Five-Point Action Plan for Critical Minerals Security*. The plan aims to facilitate co-investment in mining, processing, and recycling according to stringent environmental and social governance standards.

Last week, Japan – the G7 presidency – announced a US$788 million fund to provide up to 50 percent subsidies for Japanese corporations to develop mines and smelting projects for lithium, manganese, nickel, cobalt, and other rare earths. In a bid to bypass Chinese supply chains, Sumitomo will start sourcing neodymium-praseodymium from the US Mountain Pass rare earth mine in July. The project enjoys sizeable subsidies from the US Department of Defence. The EU introduced the Critical Raw Material Act in March, which requires that by 2030, domestically mined, recycled, and processed sources account for 10 percent, 15 percent, and 40 percent of its strategic minerals consumption, respectively.

It will be difficult to undo China's dominance. Lenient environmental regulations and low-cost labour are only part of China's advantage. Beijing's annual rare earth production quotas provide ample leverage to manipulate prices. This creates a significant disadvantage to would-be competitors. Chinese rare earth processors enjoy a sizeable cost advantage over foreign competitors, being entitled to a 13 percent value-added tax (VAT) refund when exporting value-added rare earths products. Competing countries will need to heavily subsidise their industries to compete with China.

US leans on South Korea to avoid filling China chip shortfall

Beijing weighing up ban on US chipmaker Micron

Last week, the **US** called on **South Korea** to discourage its chip manufacturers from exploiting any market gaps in China that may arise if US chipmaker Micron is sanctioned by Beijing. This comes after Chinese regulators announced in March a cybersecurity review into Micron. The review appears to be retaliation for a series of semiconductor export controls imposed by the US last October. Micron has been targeted because its memory chips are standardised and readily substitutable. If China restricts Micron, chips from South Korea should compensate for any supply shortfall.

Korean policymakers have expressed objections about a series of mostly unilateral US measures, including the *Inflation Reduction Act*, *CHIPS Act* and export controls. US policy measures were adjusted only after their implementation. The US has significant leverage over SK Hynix and Samsung due to their reliance on semiconductor manufacturing equipment. Under the terms of the October export controls, both companies will require waivers to supply semiconductor facilities in China. Business leaders have called for the US to adopt a more of a multilateral approach in coordinating technology export restrictions to China.

Bangladesh ploughs ahead with Russian nuclear plant and will pay in yuan

Bangladesh typifies the non-aligned preference of many countries in the Global South

The West's lack of influence in the Global South has been vividly illustrated by the refusal of many countries to curb relations with **Russia** after its invasion of **Ukraine**. **Bangladesh** is a case in point. The blocking of most Russian banks' access to the SWIFT messaging platform had left Dhaka with few options to repay a US$110 million loan. The loan was used to fund the still-under-construction 2,400-megawatt nuclear power plant in the country's west, which Dhaka sees as vital to meeting its growing energy consumption and reducing reliance on coal. With few alternatives, Bangladesh has opted to make the repayments using **Chinese** yuan and China's SWIFT alternative, the Cross-Border Interbank Payment System.

Whilst Bangladesh's decision may vex Western partners, it is not a case of Dhaka aligning with China or Russia. The **US** remains Bangladesh's largest export market, with Bangladesh running a large trade deficit with China. It has also recently decided to initiate a study into joining the US-led Indo-Pacific Economic Framework. **Japan** also remains a crucial partner for Dhaka, having funded Bangladesh's first industrial park, metro railway and deep-sea port. Chinese proposals for a similar port were rebuffed. Bangladesh is typical of countries which, instead of aligning fully with competing blocs, work assiduously to benefit from a range of partners.

EU and South America's Mercosur trade deal stalls over increasing EU anti-deforestation demands

Delay belies hopes that the deal would be quickly ratified under the Lula government

The signing of a free trade deal between the **EU** and South America's trade bloc **Mercosur** (**Argentina**, **Brazil**, **Paraguay** and **Uruguay**) was again delayed after the EU made additional deforestation demands. Plans to ratify the deal have, for four years, been delayed due to deep concerns regarding the previous Brazilian government's lack of policies to combat deforestation. Last month, the European Commission distributed a side letter demanding that the Mercosur countries halve deforestation by 2025 and actively reverse forest loss by 2030. This follows the introduction of EU legislation last December which prohibits the import of commodities linked to deforestation. Prospects for the deal's expeditious ratification now look uncertain, though there may be a late diplomatic scramble for progress before the EU-Latin America summit in July.

The delay to the deal is yet another factor that will present **China** as an attractive trade partner to Brazil, coming just before President **Xi**'s visit. Critics of the EU's agreement have alleged that the deal is essentially "[European] cars for beef", which will do nothing to reverse Latin America's deindustrialisation. Meanwhile, on his visit, Xi brought with him a US$570 million pledge by China's BYD to begin electric vehicle production at a plant previously operated by Ford. The EU's tough bargain approach, laudable on environmental grounds, may run up against mundane realities.

US outlines stringent vehicles emissions standards

The tougher standards are one of the first "sticks" in an otherwise all-carrots US climate policy

Washington is planning to enforce some of the world's toughest emissions standards in its latest move to promote electric vehicle uptake. Earlier this month, the US Environmental Protection Agency outlined plans to implement a fleet-wide average greenhouse gas emissions target of 51 grams of CO2 per kilometre by 2032. To reach the target, US automakers will likely be required to increase their electric vehicle (EV) sales to between 54 and 60 percent and 65 and 67 percent of their total automobile sales by 2030 and 2032, respectively. The emissions standards are highly ambitious, considering that only 5.8 percent of vehicles sold in the US last year were electric.

EVs are not yet profitable for some automakers. Ford's EV operations this year are estimated to have a gross margin of around 20 percent or more – primarily due to surging raw materials costs. If enacted, these standards will tighten the screws further. There are also supply chain concerns, prompted by strict US and US free trade partner content requirements for purchasing subsidies embedded in the *Inflation Reduction Act* (IRA). Few models are currently eligible for the full benefits, adding to the race to secure IRA-compliant materials and batteries. US automakers face a herculean task in rapidly electrifying production while simultaneously reconfiguring supply chains.

China puts on the pressure on foreign firms

Beijing's crackdown on foreign business may hinder its growth objectives

China has embarked on several campaigns to subdue foreign firms despite President **Xi** Jinping and top Chinese policymakers' calls for foreign investment. So far, Chinese authorities have questioned **US** advisory Bain & Co staff, initiated a cybersecurity review of US chipmaker Micron Technology, detained arrested an executive of Japanese drugmaker Astellas Pharma and raided US due-diligence company Mintz Group's Beijing office. China aims to tightly control the narrative on domestic affairs and limit the information foreign companies gather, which may shape the international community's perception of the country.