

# FiscalNote

## The ESG Landscape: Trends and Standards Monitor

SEPTEMBER 2022



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**Leveraging the expertise of our editorial staff, in-house analysts and policy experts from Oxford Analytica, EU Issue Tracker, CQ and FiscalNote Professional Services, we summarise and analyse the evolving ESG issues from around the globe.**

The report provides insight into industry trends, latest news, and frameworks and standards monitoring across the ESG landscape. It forms part of a comprehensive ESG Monitor that includes quarterly calls with experts to help organisations tailor their ESG strategies and response.

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## Sources you can trust



**Oxford Analytica** is the premier geopolitical analysis and advisory firm helping organisations worldwide anticipate the impact of political, economic, societal, and security risks. Businesses, governments, and international organisations trust Oxford Analytica to navigate complex markets where understanding geopolitics is critical to their success.

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**CQ's** team provides award-winning, non-partisan coverage on the policy, politics, and people of Capitol Hill. With the most established press corps on Capitol Hill, CQ has been trusted to deliver the right news, at the right time – to every congressional office, all three branches of government, the vast majority of the agencies, and thousands of organisations – for over 75 years.

### FiscalNote Professional Services

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## Executive summary

### This month's highlights

- The European Parliament voted in favour of a deforestation bill that will require companies to verify that there is no deforestation involved in the growing of at-risk commodities, including cocoa, soy and palm oil. The Parliament may also extend the scope to include grazing pigs, sheep, goats and poultry as well as growing maize and rubber, and producing charcoal and printed paper products. It may also introduce requirements for financial institutions to ensure that their activities do not contribute to deforestation.
- CDP announced that it will expand its global environmental disclosure system to help solve the plastic pollution problem, with expertise and support from The Pew Charitable Trusts, Minderoo Foundation and the Ellen MacArthur Foundation. This expansion will include the addition of questions and metrics on plastics into CDP's annual disclosure questionnaires, beginning with a pilot in 2023.
- A new Securities and Exchange Commission (SEC) rule on 'universal proxy cards' was mandated for use for the first time in US corporate board elections. Public companies will now have to use the new style of proxy card that allows investors to mix and match their votes.
- In the United States, Florida Governor Ron DeSantis again accused large US companies of attempting to shift public policy away from the Republican agenda. Some energy-producing states under Republican control continued to advance legislation that restricts ESG constraints on fossil fuel companies. Yet most shareholders are showing little inclination to move away from ESG policies, suggesting further tensions between senior executives and leading Republicans.
- A new trend added this month sees US companies reassess China risks in the context of ESG and growing US-China tensions. US companies face heightened scrutiny of their global supply chains following the implementation of the Uyghur Forced Labor Prevention Act in June alongside evidence of human rights abuses in the Xinjiang region of China. Investors focused on ESG issues are urging companies to evaluate whether modern slavery is prominent among suppliers in China and across the globe.

### What to watch

- Companies' exposure to activist campaigns focused on ESG issues and proxy fights is expected to rise with the new universal proxy card mandate, offering an easier path for investors like Engine No. 1, which got three of its candidates elected at Exxon Mobil last year by securing backing from major investors such as BlackRock.
- US states may follow Texas in expanding anti-ESG protections, creating a complex new patchwork of corporate risk. The anti-ESG investing trend is likely to intensify in the run-up to the US midterm election, and perhaps for as long as the total energy crisis persists, forcing companies to determine their portfolio strategy carefully.

### Stay ahead of the curve

- ESG professionals need to keep track on where in China their company has operations or suppliers. However, limited visibility into Chinese domestic supply chains will pose challenges to assessing the level of human rights risks.

### Upcoming events and meetings

**Oct 13-15:**

[UN Women Leaders Forum: Building nature-positive economies and societies, Jeju, South Korea](#)

**Oct 13:**

[Natural Capital Summit 2022, London](#)

**Oct 17-21:**

[ISSB meeting, Montreal](#)

**Nov 6-18:**

[UN Climate Change Conference 2022 \(UNFCCC COP 27\), Sharm El-Sheikh](#)

**Nov 22-23:**

[Reuter's ESG Investment Europe 2022, London](#)

**Dec 5-17:**

[UN Biodiversity Conference \(COP 15\), Montreal](#)

# Trends dashboard

GLOBAL	NOTE	RATING	TRAJECTORY
ESG rating agencies face scrutiny over methodologies and scoring			
Companies face growing ESG-related litigation risk			
Non-CO2 greenhouse gases receive increased regulatory attention			
Sustainable funds under pressure to perform			
Financial institutions put emphasis on climate stress testing			
Biodiversity and nature-related risk rises up corporate agendas			
Auditors urged to review impact of climate change			
Water security becomes a strategic concern for corporate leaders			
Companies link executive pay to ESG performance			
Growing employer monitoring of employees leads to privacy concerns			
Investment into climate-friendly or natural assets grows			
Companies tackle plastic waste as part of ESG initiatives (but efforts remain nascent)			
Growing geopolitical tensions impact the global ESG landscape			
Systemic inequality presents business risks			
UNITED STATES			
Increase in shareholder votes on ESG issues			
The SEC moves forward on ESG disclosure matters			
Businesses face pressure to speak out on social issues			
ESG becomes a battleground in the 'culture wars'			
Investors push for racial equity audits			
US companies reassess China risks in the context of ESG			
Greater scrutiny of corporate political spending in the context of ESG			
Board diversity requirements face legal challenges			
EUROPEAN UNION			
The EU raises its ambitions on climate legislation			
The EU broadens the scope of its non-financial disclosure requirements			
The EU extends its carbon market			
The EU takes steps to introduce a politically contentious carbon border tax			

## Rating



### Very strong

The direction of change is clear and measurable. The trend will cause the issue that is trending to become qualitatively different



### Strong

The direction of change is clear, consistent and measurable



### Weak

The direction of change is weak, unclear or partial. There are some observable examples of the trend



### Potential

Issues 'on the radar', but that have not yet become a trend

## Trajectory



Strengthen



Remain stable



Weaken

## Trend status



New trend



Update on existing trend



# Trends

## Trend updates

### Global: Biodiversity and nature-related risk rises up corporate agendas

*Organisations are starting to recognise the risks and opportunities related to biodiversity and nature loss, but the financial sector is far from mainstreaming nature as an issue. The economic implications of biodiversity decline go beyond agriculture, reverberating through supply chains to consumer-facing businesses and affecting local livelihoods.*

#### Update

On September 13, the European Parliament voted in favour of a deforestation bill that will require companies to verify that there is no deforestation involved in the growing of at-risk commodities, including cocoa, soy and palm oil. The Parliament issued a [press release](#) on the same day, highlighting that it wishes to extend the scope to include grazing pigs, sheep, goats and poultry, as well as growing maize and rubber, and producing charcoal and printed paper products. It may also introduce requirements for financial institutions to ensure that their activities do not contribute to deforestation.

The bill has seen a backlash by producer countries, with some calling it a 'political protectionist tool', for example the Indonesian Palm Oil Association. The next step is for the European Parliament to start negotiations on the final law with EU member states. The Parliament aims to close the negotiations before the 15th Conference of Parties (COP15) to the United Nations Convention on Biological Diversity (CBD), which will take place from December 7-19, 2022, in Montreal, Canada.

Despite global interest, deforestation levels in Brazilian Amazonia have increased in seven of the past nine years, reaching 13,038 square kilometres in 2021, according to the National Institute for Space Research (INPE). During his 2018 election campaign, Jair Bolsonaro made clear his anti-environmentalist stance. In office, he has taken an approach to the area which Brazilian Supreme Federal Court Justice Carmen Lucia has described as a "termite infestation", with measures that eat away from within at the effectiveness of relevant institutions. Environmental policy is not a voter priority in Brazil, but most favour improved conservation, which would also bolster Brazil's international relations. Nevertheless, deforestation is unlikely to slow significantly in the near term.

In related developments, Indonesia and Norway signed a memorandum of understanding (MoU) on September 12 for a five-year deal where Oslo will pay Jakarta to cut greenhouse gas (GHG) emissions from deforestation and forest degradation. The MoU comes just over a year after Indonesia terminated a similar pact with Norway. Indonesia has the third-largest expanse of rainforest after the Amazon and the Congo basin.

#### Additional reading

[Deforestation and Forest Degradation \(Proposal\): European Parliament Adopts Internal Position, EU Issue Tracker, September 14, 2022;](#)

[Deforestation and crime expand in Brazil's Amazonia, Oxford Analytica Daily Brief, September 5, 2022;](#)  
[Norway deal will help Indonesia reduce deforestation, Oxford Analytica Daily Brief, September 27, 2022](#)

#### Rating



Weak

#### Trajectory



Strengthen

## Global: Water security becomes a strategic concern for corporate leaders

*Water security is moving beyond being a plant-level operational issue for companies, to become a strategic question for senior management.*

### Update

In late August, the Chinese government announced a nationwide drought warning following a record-breaking 70-day continuous heatwave with sustained temperatures above 40 degrees Celsius. Mainly affected have been China's southern regions, which are intended to provide net water transfers to other parts of the nation through a massive south-north engineering project. Reduced rainfall and increased evaporation in the watershed of the Yangtze River, China's longest watercourse and a transportation artery, have affected navigation and led to the lowest water levels since records began in 1865.

From the perspective of global companies that rely on data centres in China, the changing climate causes particular problems where data centres have been located specifically to benefit from local cooling effects, such as in the mountainous and impoverished south-western province of Guizhou. Drier weather may also compound disruptions caused by China's zero-COVID strategy: as of mid-September, Guizhou's capital of Guiyang, where the data storage industry serves major digital technology providers including Apple, was under pandemic lockdown.

China's southern and south-western provinces rely heavily on hydropower and transfer hydropower-generated electricity to the eastern provinces. As reported last month, in mid-August, Sichuan province, which relies on hydropower for 80% of its energy usage, saw its hydropower generation capacity fall by half. The provincial government required factories to ration power usage, leading to reduced production or complete shutdowns, including by major foreign operators such as Volkswagen and Toyota. The shutdowns also affected global supply chain vendors such as Foxconn and CATL.

### Additional reading

[Water shortage is a major threat to China](#), *Oxford Analytica Daily Brief*, September 14, 2022

### Rating



Weak

### Trajectory



Strengthen



## Global: Companies link executive pay to ESG performance

*As companies face greater stakeholder expectations of ESG engagement, stricter regulation and more scrutiny surrounding their ESG disclosure and impact, they are aligning their executive incentive-pay structure with their corporate ESG goals.*

### Update

In late August, the Securities and Exchange Commission (SEC) adopted the 'pay versus performance' disclosure [rule](#), which has been in the works since it was proposed in 2015. Under the new rule, public companies will have to disclose more information on executive compensation and how that compensation is tied to the company's financial performance. SEC Chairman Gary Gensler said in a statement the new rule "makes it easier for shareholders to assess a public company's decision-making with respect to its executive compensation policies."

The rule will require companies to include a table in their proxy or information statements disclosing certain executive compensation and financial performance measures for their five most recently completed fiscal years. Using information in the table, companies will also have to describe the relationships between the executive compensation paid and each of the performance measures, among other disclosures.

Companies must comply with the new disclosure requirements for fiscal years ending on or after December 16, 2022. While the rule does not require disclosure of ESG metrics, companies can supplement financial performance measures with non-financial performance measures such as ESG.

## Global: Companies tackle plastic waste as part of ESG initiatives (but efforts remain nascent)

*Companies have started tackling plastic waste as part of ESG initiatives, but mismanagement remains a widespread problem and is acute in many developing economies. Multinationals are involved in various voluntary initiatives to reduce waste and demand for virgin plastics, but ambitions and outcomes vary among firms.*

### Update

CDP, a charity that runs a global disclosure system for managing environmental impacts, [announced](#) on September 22 that it is expanding the system by asking companies for more data on their use of, and related pollution from, plastic. CDP will start these requests for major corporations in 2023.

"With over 13,000 companies worth 64% of global market capitalisation already disclosing through CDP, our disclosure system is uniquely positioned to scale disclosure on plastics across the global economy," Nicolette Bartlett, the organisation's chief impact officer, said in a statement.

Plastic pollution has been a concern in certain sectors, such as consumer goods, fossil fuels, retail, and the food and beverage industry. While plastics remain a smaller issue within shareholder proposals related to ESG, they are gaining traction. For example, at General Mills' annual meeting on September 27, 55% of shareholders voted in favour of a proposal from Green Century Capital Management calling on the company to determine whether and how the company can increase the scale, pace and rigour of its sustainability efforts by reducing plastic packaging.

#### Rating



Weak

#### Trajectory



Strengthen

#### Rating



Weak

#### Trajectory



Stable

## Global: Growing geopolitical tensions impact the global ESG landscape

*Changing geopolitics is affecting both the understanding and implementation of ESG.*

### Update

Russia's war against Ukraine is taking a major toll on European markets, including ESG investing, according to the European Securities and Markets Authority (ESMA). In a [report](#) published on September 1, ESMA found that ESG bond issuance volumes fell 29% during 2022 through June compared to last year. "Yet, some fundamental factors driving the rise of ESG investing remain," ESMA said. "In particular, investor preferences continued to shift towards sustainable investments, with portfolio allocations increasingly tilted towards ESG investments."

Meanwhile, the Russian invasion highlights the importance of the social pillar in ESG investing, the regulator said. "The invasion raised questions on the compatibility of sustainable investment practices with the financing of non-democratic regimes or weak democracies." It further noted that ESG investors have started paying more attention to the social impact of their investments as a consequence of this.

The war also challenged the EU's climate objectives as several countries turned to coal to compensate for lower Russian fossil fuel imports, ESMA said. The EU has said it wants at least 40% cuts in greenhouse gas emissions by 2030.

## US: Increase in shareholder votes on ESG issues

*Activist investors feel more empowered to table proxy ballots on climate change and human capital management after the SEC reversed Trump administration policies that enabled companies to avoid putting some shareholder proposals to a vote.*

### Update

A new SEC rule on 'universal proxy cards' was mandated in September for use for the first time in US corporate board elections. Under the rule, public companies will have to use the new style of proxy card that allows investors to mix and match their votes instead of picking an entire slate backed either by company management or an activist.

Shareholders will be able to calibrate their sentiments more precisely, and vote for as much or as little change as they want. Activist investors will benefit as shareholders have more flexibility to change a company's business strategy as they usher in independent candidates.

Companies' exposure to activist campaigns focused on ESG issues and proxy fights is expected to rise, offering an easier path for investors like Engine No. 1, which got three of its candidates elected at Exxon Mobil last year by securing backing from major investors such as BlackRock.

### Additional reading

[More battles over board seats seen with universal proxy rule](#), CQ News, September 7, 2022

### Rating



Potential

### Trajectory



Strengthen

### Rating



Strong

### Trajectory



Strengthen

## US: ESG becomes a battleground in the ‘culture wars’

Many ESG issues now sit in the crossfire of the intensifying culture wars in the United States between conservative Republicans and progressive Democrats. For example, Republican state leaders have proposed laws that would ban state investment vehicles from considering ESG when making investment decisions.

### Update

On September 11, Florida Governor Ron DeSantis again accused some large US companies of attempting to shift public policy away from the Republican agenda. Five Republican-controlled energy producing states -- Texas, West Virginia, Kentucky, Oklahoma and North Dakota -- as well as Arizona and Florida have already adopted anti-ESG laws that exclude banks and investment funds with certain ESG policies from public finance contracts in the state. Louisiana's Democratic governor vetoed similar legislation passed by its Republican legislature. Several other states have anti-ESG legislation pending (see graphic below).

#### Rating



Weak

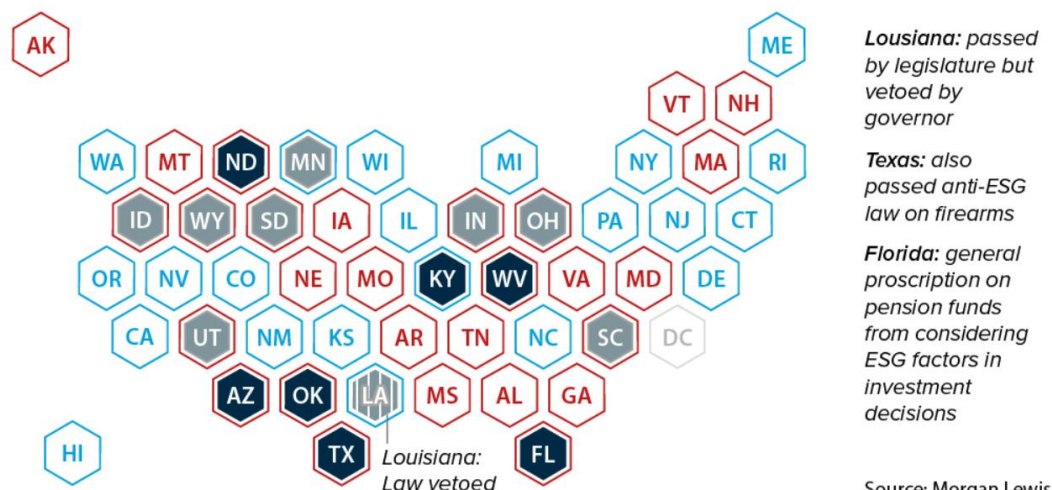
#### Trajectory



Strengthen

### United States: Anti-ESG legislation by state (as of end-September 2022)

Anti-ESG law on fossil fuels: ■ Passed ■ Pending State Governor: ○ Democrat ○ Republican



Many Republican lawmakers at the state and federal level have also criticised ESG rankings as burdensome and harmful. On September 20, Senate Banking Committee ranking Republican Patrick J. Toomey asked twelve credit rating and data analytics firms for information on how they calculate companies’ ESG scores. In [letters](#) to the companies, Toomey asked them to provide copies of non-proprietary methodologies used to assign ESG ratings. He also requested answers on potential compliance burdens, credibility of third-party data, political issues’ role in ESG scores and potential conflicts of interest. The letters -- which were sent to MSCI, Institutional Shareholder Services, Bloomberg, Morningstar subsidiary Sustainalytics, Moody’s Investors Service, CDP, S&P Global, London Stock Exchange Group subsidiaries FTSE Russell and Refinitiv, RepRisk, FactSet Research Systems and Arabesque S-Ray -- marks the latest in Republicans’ rebuke of ESG. Many Republican lawmakers including Toomey remain adamant that ESG considerations are politically based and immaterial.

On September 6, Vivek Ramaswamy, founder and executive chairman of the anti-ESG firm Strive Asset Management, sent a [letter](#) to Chevron CEO Michael Wirth asking the oil and gas company to embrace a “post-ESG” shareholder mandate by increasing its spending on fossil fuel production, cancel all commitments to scope 3 emissions reductions, stop advocating for a carbon tax and cease publishing ESG reports.

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While some energy-producing states under Republican control are advancing legislation that restricts ESG constraints on fossil fuel and firearms companies, shareholders are showing little inclination to move away from ESG policies. This suggests further tensions ahead between senior executives and leading Republicans. Populist criticism of corporate ‘wokeness’ will continue until November’s midterm elections and probably beyond, but the financial cost to states of passing anti-ESG laws may become more apparent over time. The longer-term momentum of anti-ESG efforts will depend in part on the extent of Republican control in Washington. For example, a Republican president who is ready to undo Biden’s energy transition agenda would support limits on the environmental dimension of ESG policies.

**Additional reading**

[Some US states are passing anti-ESG legislation](#), *Oxford Analytica Daily Brief*, September 30, 2022

## New trends this month

### Global: Systemic inequality presents business risks

#### Trend description

For corporate leaders, systemic inequality -- which was underscored by the COVID-19 pandemic and is likely to worsen due to a combination of global warming impacts and the rising cost of living together with a global growth slowdown -- increasingly presents a source of ESG-related business risk. For institutional investors, it has the potential to negatively impact global portfolios.

#### Latest developments

The social and economic effects of widening inequalities extend beyond impacts on the poor. Growing inequalities place a strain on political systems in ways that can inhibit cooperation on climate action and mitigation and contribute to political instability and protectionism.

The Taskforce on Inequality-related Financial Disclosures (TIFD) was formed last year with a mission to reduce the contributions of the private sector to inequality and also to minimise the effects of inequality on the private sector. Inspired by the Task Force on Climate-related Financial Disclosures (TCFD), TIFD is developing a disclosure framework that will help both companies and investors to measure, report on and manage inequality-related impacts and risks. TIFD held its first global meeting in July this year.

In June, the Business Commission to Tackle Inequality (BCTI) published a [report](#) urging business to take action to address growing systemic inequalities. Inequality, according to the BCTI, has implications for business performance, limiting productivity and innovation, dampening consumer confidence and spending, destabilising supply chains, increasing uncertainty in the political and regulatory environment, and deepening disruptions from COVID-19 to climate change. The report points out six key areas for business action to tackle inequality, including: 1) respecting human rights; 2) enhancing access to essential products and services; 3) creating jobs and economic opportunities for all; 4) distributing value and risk equitably; 5) enabling government action; and 6) climate and nature action.

#### Outlook

Wealth and income inequality will persist (and in some cases worsen). Still-high inflation and interest rates will raise the cost of living further, deter consumption and investment and dampen global GDP growth. The global economic slowdown could be shallower than the COVID-19-induced recession but is likely to last longer. Global GDP growth and trade may struggle to bounce back in 2023-24, although a lot will depend on fiscal and monetary policies.

#### Rating



Potential

#### Trajectory



Stable

## US: US companies reassess China risks in the context of ESG

### Trend description

US companies selling into the Chinese market, and thus with local operations, have long been at risk of arbitrary punitive measures that can range from non-routine tax inspections to 'spontaneous' patriotic consumer boycotts of their products. They must now navigate the additional challenge of Western human rights sanctions over Xinjiang and anti-Western cooperation between Moscow and Beijing. Investors focused on ESG issues are urging companies to evaluate whether modern slavery is prominent among suppliers in China and across the globe.

### Latest developments

US companies face heightened scrutiny of their global supply chains following the implementation of the [Uyghur Forced Labor Prevention Act](#) (UFLPA) in June. The bipartisan legislation followed growing evidence that the Uyghur people and other ethnic minorities in China's Xinjiang region have been coerced into work at factories, farms and mines for various industries including suppliers for apparel companies, food brands, solar panel makers, electric vehicle manufacturers and tech companies. The UFLPA law's implementation is an opportunity for companies to look at how supply chains align with corporate ESG goals, including public commitments on responsible sourcing and human rights, and where they can improve on such metrics.

On August 31, the Office of the UN High Commissioner for Human Rights (UNHCHR) issued a [report](#) on human rights concerns in the Xinjiang region of China following three years of investigations. The report details accounts of a diverse range of human rights abuses and says that "The extent of arbitrary and discriminatory detention of members of Uyghur and other predominantly Muslim groups [...] may constitute international crimes, in particular crimes against humanity".

An annual [survey](#) conducted by the US-China Business Council of US companies operating in China shows that multinationals are reviewing their strategies. As the survey, published on August 29, suggests, the worsening of US-China relations, particularly over Taiwan, together with COVID-19-related supply chain disruption and Western political pressure to disengage from China, has prompted Western multinationals to reassess their Chinese business risks. Apple, Google, Dell and Amazon are among the US tech giants expanding production in Vietnam to establish supply chains outside China, as textile and apparel producers did before them.

### Outlook

The recent UNHCHR report will make it more difficult for Western governments to resist pressure to penalise China for its activities in Xinjiang, and increase the compliance and reputational risk of doing business with China. The Chinese Communist Party Congress in October and US midterm elections in November make any near-term improvement in US-China relations unlikely, elevating reputational, policy and legal risks for Western companies.

### Additional reading

[US companies reassess China risks](#), *Oxford Analytica Daily Brief*, September 1, 2022

#### Rating



Weak

#### Trajectory



Strengthen



# Frameworks & standards monitoring

**SEPTEMBER 2022**

CDP: 8 updates

GRI: 8 updates

IFRS: 7 updates

TCFD: 0 updates

TNFD: 0 updates

# CDP (formerly the Carbon Disclosure Project)

## How European green cities can track their progress through CDP

Sept 1, 2022

News Update

This article discusses the EU Green City Accord, a movement of European mayors committed to making their cities greener, cleaner and healthier by improving air, water, waste, noise pollution, urban nature and biodiversity.

[Link](#)

## Missing the Mark: 2022 analysis of global CDP temperature ratings

Sept 6, 2022

Report

This report uses CDP's latest temperature ratings to assess whether current corporate emissions reduction targets are ambitious enough to meet the Paris Agreement's 1.5° Celsius goal. The report's analysis shows that the greenhouse gas emissions reduction targets publicly disclosed by companies in G7 economies are still only ambitious enough to align with a 2.7°C decarbonisation pathway.

[Link](#)

## CDP's comment on The European Parliament's vote in favour of a new EU Anti-deforestation law

Sept 14, 2022

Press Release

CDP welcomes the European Parliament's vote in favour of a new EU Anti-deforestation law, which bans products linked to the destruction of forests. This law will help ensure that companies under the EU taxonomy take proper action in addressing deforestation throughout their supply chains and will have the potential to stop financial institutions from funding deforestation.

[Link](#)

## Seeking clarity amidst fragmentation: The development of sustainable finance taxonomies and the drive towards integration in CDP's disclosure system

Sept 20, 2022

Report

In this report, CDP ran an analysis of existing sustainability finance taxonomies and identified eight elements that can help classify sustainable finance taxonomies. These elements were divided into three clusters: objectives, scope and detail. In addition, there are criteria for prioritisation, which include reach. Further, the report proposes an integration model of sustainable finance taxonomies into CDP's disclosure system.

[Link](#)

## TCFD Insights Series

Sept 20, 2022

Report

This report reveals how the world's largest companies are assessing their exposure to climate risks and opportunities. It does by evaluating the level of TCFD alignment for 80% of companies listed on the S&P 500 stock market index that responded to the 2021 CDP climate change questionnaire. 55% of these companies were 90-99% aligned with the TCFD's key recommendations, however, this dropped to only 14% to all relevant questions in the CDP questionnaire.

[Link](#)

## CDP expands global environmental disclosure system to help tackle plastic pollution crisis

Sept 22, 2022

Press Release

CDP announced that it will expand its global environmental disclosure system to help solve the plastic pollution problem, with expertise and support from The Pew Charitable Trusts, Minderoo Foundation and the Ellen MacArthur Foundation. This expansion will include the addition of questions and metrics on plastics into CDP's annual disclosure questionnaires, beginning with a pilot in 2023.

[Link](#)



### Powering a Green Recovery: How EU recovery funds can support investors and the European Green Deal

Sept 27, 2022

Report

This CDP report provides an overview of the long-term EU budget and EU recovery funds, and how these are targeted to promote a green and resilient future. The purpose of the report is to highlight the opportunity for investors to become involved in facilitating the green transition and considerations for both investors and policymakers in sustainability-linked public funding programmes.

[Link](#)

### What actions should companies be taking to lead the decade of delivery?

Sept 29, 2022

News Update

During CDP's recent workshop, Leading the Decade of Delivery, sustainability practitioners from across Europe came together to discuss key developments in environmental reporting and action this year. This resulted in five key takeaways. 1) It is not enough to focus on climate change. 2) Companies must consider their impacts and strategy on biodiversity. 3) Ambitious corporate climate action must include the value chain. 4) Having both science-based targets and transition plans in place is crucial. 5) Disclosing to CDP sets companies up for new regulatory reporting standards.

[Link](#)

# GRI (Global Reporting Initiative)

## Deepening corporate sustainability in Latin America

Sept 5, 2022

News Update

This article discusses the hundreds of companies in Latin America that were supported to produce a GRI sustainability report for 2021, through the Sustainability Reporting for Responsible Business programme from GRI in collaboration with Switzerland's State Secretariat for Economic Affairs. The companies involved committed to a four-month programme which consisted of education on sustainable development, sustainability strategy, data collection and stakeholder engagement.

[Link](#)

## GRI Topic Standards – Project Labor related Standards

Sept 15, 2022

Standards Update

As part of the Global Sustainability Standards Board (GSSB) Work Program 2020-2022, the GSSB has identified the need to review the labour-related GRI Topic Standard. This document outlines the approach to which a review will be done. The review has been split into two phases: the first includes a conceptual review of the human rights-related content within the GRI Standards and overall alignment with key authoritative intergovernmental instruments, and the second is the review of individual GRI Topic Standards with human rights and labour-related content.

[Link](#)

## Topic Standard Project for Human Rights

Sept 15, 2022

Standards Update

The main objective of this project is to bring the GRI human rights-related standards in line with key authoritative intergovernmental instruments in this area, namely the UN Guiding Principles on Business and Human Rights and OECD instruments. The project aims to review and revise the range of human rights-related topics covered in the standards and the related disclosures to ensure they reflect best practices.

[Link](#)

## 25 years of empowering sustainable decisions

Sept 15, 2022

News Update

GRI reached its 25th anniversary in September. The publication 25 Years as the Catalyst for a Sustainable Future charts GRI's journey so far, including the evolution of sustainability guidelines and standards and

their role in achieving corporate accountability for the sustainable development agenda.

[Link](#)

## Accountability on human rights: labor standards up for review

Sept 20, 2022

News Update

Following the launch of a project to update labour topic standards, human rights reporting is set to be further integrated into GRI standards. The Global Sustainability Standards Board has appointed a Technical Committee, with representatives from the International Labour Organization, International Organisation of Employers, and trade unions, to lead the process.

[Link](#)

## Global Goals Week: get inspired by our SDGs podcast

Sept 22, 2022

News Update

In this article on Medium, Camila Corradi Bracco, GRI Policy Senior Coordinator, discusses the first half (episodes 0-8) of the podcast series The Rising Tide. The Rising Tide series brings together expert perspectives from the public and private sectors.

[Link](#)

## Towards corporate transparency in the Greater China Region

Sept 26, 2022

News Update

GRI has published translations of its Universal Standards 2021 into Simplified Chinese and Traditional Chinese. This follows its commitment to deepen engagements in Mainland China, Hong Kong and Taiwan.

[Link](#)

## Setting the building blocks for reporting in Bangladesh

Sept 29, 2022

News Update

A recently concluded programme for reporters in Bangladesh provided technical assistance and shared practical knowledge on the steps of preparing a GRI-based report. This programme included immersive and one-on-one training sessions with companies on the key elements of reporting.

[Link](#)

# IFRS (International Financial Reporting Standards) Foundation

## IFRS Foundation announces appointments to Sustainability Consultative Committee

Sept 6, 2022

News Update

The Trustees of the IFRS Foundation have confirmed the appointment of seven organisations and representatives to the Sustainability Consultative Committee (SCC). This follows the completion of the International Sustainability Standards Board (ISSB) member appointments announced in August. The SCC's goal is to identify, inform and advise the ISSB on priority sustainability matters and related technical protocols, as well as significant interdependencies between sustainability matters.

[Link](#)

## Webinar: Staff Request for Feedback on the IFRS Sustainability Disclosure Taxonomy

Sept 12, 2022

Event

The IFRS Foundation held a live webinar on the Staff Request for Feedback on the IFRS Sustainability Disclosure Taxonomy to inform the development of an IFRS Sustainability Disclosure Taxonomy for digital reporting.

[Link](#)

## African ministers support the ISSB's work and call for early adoption of its Standards by African jurisdictions and companies

Sept 13, 2022

News Update

African ministers, senior officials responsible for finance, environment and sustainable development; and other representatives of international bodies and development institutions have expressed support for the work of the ISSB in a communique published in relation to the International Cooperation Forum and Meeting of African Ministers of Finance, Economy and the Environment in Egypt on September 7-9.

[Link](#)

## ISSB Meeting, Frankfurt

Sept 20-23, 2022

Meeting

The ISSB met in Frankfurt, Germany, where they discussed feedback provided in comment letters and in responses to its survey on General Requirements for Disclosure of Sustainability-related Financial Information (draft S1) and Exposure Draft IFRS S2 Climate-related Disclosures (draft S2).

[Link](#)

## September 2022 ISSB podcast now available

Sept 29, 2022

News Update

In this episode of the ISSB podcast, ISSB Chair Emmanuel Faber and Vice-Chair Sue Lloyd discuss highlights from the second ISSB meeting in Frankfurt, including key developments since the last board meeting, the importance of proportionality and scalability, and expectations for the October meeting in Montreal.

[Link](#)

## Meet the Experts—with contributions from the IFRS Foundation and PwC

Nov 7-8, 2022

Event

Andreas Barckow, Chair of the IASB, Sue Lloyd, Vice-Chair of the International Sustainability Standards Board, and IASB Member Nick Anderson are a few of the speakers from the IFRS Foundation who will be at this year's Meet the Experts. The event brings together standard-setters, regulators, investors, and industry professionals to discuss current accounting developments and critical economic and regulatory updates for reporting professionals in order to stay ahead of the reporting curve. Plenary sessions include an ISSB update.

[Link](#)

## ISSB meeting, Montreal

Oct 17-21, 2022

Meeting

The ISSB's October meeting will be held in Montreal, Canada, on the week commencing October 17. Agenda is forthcoming.

[Link](#)

# TCFD (Task Force on Climate-Related Financial Disclosures)

No relevant updates for the month of September.

# TNFD (Taskforce on Nature-related Financial Disclosures)

No relevant updates for the month of September.



# Additional reading

First published in EU Issue Tracker, Sept 14, 2022

## Deforestation and Forest Degradation (Proposal): European Parliament Adopts Internal Position

September 14, 2022

The European Parliament's plenary adopted its internal position on the proposal for a Regulation on commodities and products associated with deforestation and forest degradation.

### Latest

- The Report of the Committee on the Environment, Public Health, and Food Safety (ENVI) was presented in plenary on 12 September 2022.
- The European Parliament adopted its position on the Commission proposal on 13 September 2022.
- The text of the amendments adopted was made publicly available on the same day.
- The European Parliament published a press release on the adoption of the Resolution on 13 September 2022.

### Analysis

Ahead of its adoption as a Resolution, the ENVI Report as prepared by Rapporteur Christophe Hansen (EPP, Luxembourg) was presented in plenary on 12 September 2022.

The Rapporteur highlighted that EU Member States are responsible for 10% of global deforestation and that the matter should be tackled at the global level. Therefore, the European Parliament proposed to extend the scope of the Regulation to cover more commodities and derived products.

MEP Hansen further stressed that traceability of products is necessary for the proper implementation of the new rules. Moreover, he noted that the measure needs to be in line with the World Trade Organisation (WTO).

Rapporteur Anna Cavazzini (Greens/EFA, Germany) of the Associated Committee on the Internal Market and Consumer Protection (IMCO) believed that the more ambitious the legislation is, the better. She also underlined that the IMCO Committee stressed the importance of proper implementation, the rights of indigenous peoples and the climate.

The Commissioner for Environment, Oceans and Fisheries, Virginijus Sinkevičius, stated that the initiative addresses both the challenges of climate change and biodiversity loss. He reiterated that both illegal and legal deforestation should be addressed by the measure.

MEP Hildegard Bentele (EPP, Germany) stated that the EU as a market-maker should use its power but suggested changing a few things on certification to get small and medium-sized enterprises (SMEs) on board.

MEP Delara Burkhardt (S&D, Germany) advocated for sustainable deforestation-free products without infringements of human rights.

MEP Nicolae Ștefănuță (Renew Europe, Romania) believed that action on behalf of the EU is not enough and that EU leaders should act more drastically.

MEP Marie Toussaint (Greens/EFA, France) argued that criminalising products coming from deforestation is an important first step in the long battle against deforestation.

MEP Aurélie Beigneux (ID, France) stated that calling on countries to give up their sovereignty and protectionism is not the answer to this problem.

MEP Anna Zalewska (ECR, Poland) believed that the draft has gone beyond what we should be doing but noted that controlling the financing of these products is important.

MEP Anja Hazekamp (GUE/NGL, the Netherlands) stressed that meat, maize and other products that lead to deforestation should not be sold.

The MEP stated that defunding the deforestation of the Amazon is key and that financial institutions hold an important role in this regard. Additionally, she argued that European agricultural subsidies should be abolished.

Commissioner Sinkevičius stressed that no commodity or product originating from deforestation harming the rights of indigenous people will enter the EU by virtue of the Regulation. The commodities included in the Commission's proposal cover over 80% of products that contribute to global deforestation.

He stated that the Regulation has a progressive scope that will be enlarged and reviewed according to new trends and data but that the commodities covered at this stage are proven to have the biggest impact in global deforestation, which will be essential for international recognition.

If financial institutions were to be included in the proposal, two new tracks of monitoring and enforcement would need to be developed according to the Commissioner. Instead, he believed that the broader sustainable finance framework will complement the Deforestation Regulation.

Rapporteur Hansen closed off the debate by stating that we need to ensure that the legislation is a model for the rest of the world, not a model to avoid because of a very high threshold.

On 13 September 2022, the MEPs adopted the amendments to the Commission proposal with 453 votes in favour, 57 against and 123 abstentions. Primarily ECR, ID and a few EPP MEPs voted against the position.

Following the vote, the European Parliament made available the text of its internal position.

Compared to the text of the ENVI Report, an amendment has been added to define 'produced' as "grown, harvested, or obtained on relevant plot of land, or, in the case of livestock, 'produced' means all relevant plots of land involved in the livestock rearing process".

Additionally, a paragraph would be added to Article 28 to require the Commission and the Council to further engage to implement and enforce trade agreements as well as concluding new FTAs that include strong provisions on sustainability and the obligation to effectively enforce multilateral environmental agreements.

Moreover, compared to the ENVI Report, salted poultry meat and prepared and preserved poultry have been added to the scope of the measure.

The Parliament issued a press release on the same day, highlighting that it wishes to extend the scope to include pigmeat, sheep and goats, poultry, maize, rubber, charcoal and printed paper products and to introduce requirements for financial institutions to ensure that their activities do not contribute to deforestation.



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Additionally, the Parliament argues that companies placing products on the EU market should verify that goods are produced in accordance with human rights provisions, respect the rights of indigenous peoples and exercise due diligence to evaluate risks in their supply chain.

The European Parliament and the Council can now begin the interinstitutional negotiations (trilogues) on the proposal for a Regulation.

### **Next steps**

The proposal follows the ordinary legislative procedure under the Lisbon Treaty.

Following its adoption on 17 November 2021, the proposal for a Regulation was sent to the European Parliament and the Council for examination.

As the Council adopted its General Approach on 28 June and the Parliament adopted its internal position on the proposal on 13 September 2022, informal negotiations (trilogues) can take place with the aim of reaching an interinstitutional agreement.

Any resulting agreement would need to be approved by the European Parliament and by the Council.

In particular, the text of the agreement will be submitted to the European Parliament's ENVI Committee for approval and then to plenary for adoption. If approved, the text will need to be formally adopted by the Council.

In this case, the procedure would be concluded at first reading and the legislative act would be published in the Official Journal and enter into force.

Oxford  
Analytica

First published in The Oxford Analytica Daily Brief, Sept 5, 2022

## Deforestation and crime expand in Brazil's Amazonia

Monday, September 5, 2022

Following improvements in the mid-2000s, deforestation and greenhouse gas emissions have been rising in recent years

There were 33,116 fires reported in Amazonia during August, the highest number for the month since 2010. Brazil recorded considerable improvements in the conservation of Amazonia in the decade from the mid-2000s. However, tighter budgets since the mid-2010s and the openly anti-environmentalist stance of far-right President Jair Bolsonaro, in power since January 2019, have led to rising deforestation rates and an associated increase in greenhouse gas (GHG) emissions.

### What next

Amazonian deforestation is unlikely to slow in the short term. The eroded institutional capacity of relevant government agencies, the involvement of transnational organisations with environmental crime in the region and policies that have empowered armed land-grabbers and illegal mining, logging, fishing and hunting, mean that even a reversal of cuts to the environmental budget would not necessarily improve conservation. Violence in Amazonia, already extremely high, will probably continue to increase in coming years.

### Subsidiary Impacts

- The army could become increasingly involved in tackling environmental crime in Amazonia if Bolsonaro loses this year's election.
- Environmental policy is not among voters' priorities, but most favour improved conservation.
- Legal decisions may become more relevant in environmental policy processes.

### Analysis

The Amazonian rainforest, of which 60% is in Brazilian territory, plays a key role in the world's carbon and water cycles:

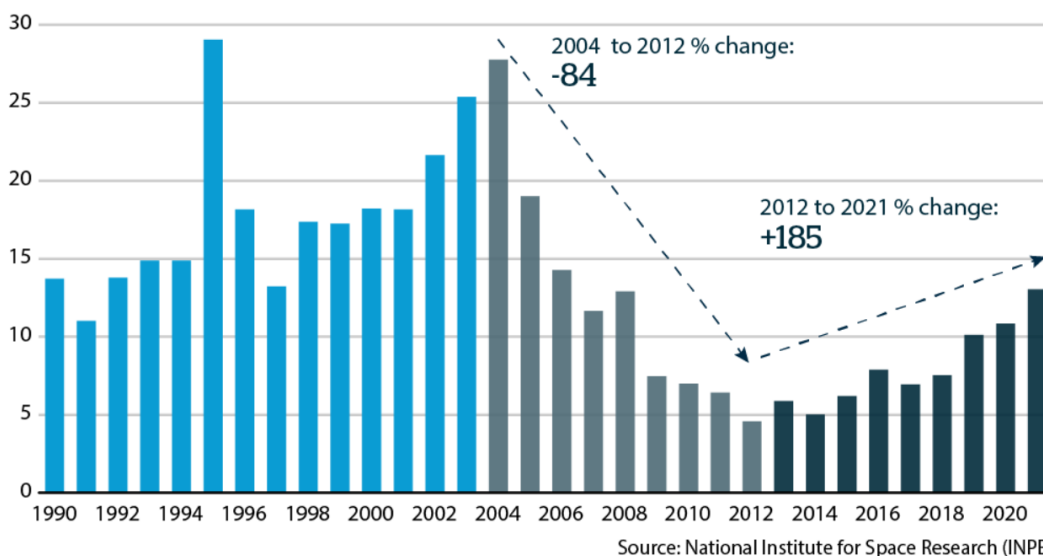
- Its trees store an amount of carbon corresponding to between two and three times UK emissions accumulated since pre-industrial times. When trees are cut or burned, they do not just cease to sequester carbon, but also release stored carbon into the atmosphere.
- Through the process of transpiration (drawing water from the soil and releasing it into the atmosphere), Amazonia's trees play a key role in the water cycle that supports agriculture elsewhere in Brazil, but also in Argentina, Uruguay and Paraguay. The water from transpiration joins moisture blown in on the wind from the Atlantic Ocean and hits the Andes to the east, creating 'flying rivers' that run south.

These roles, in addition to the fact that the world's largest rainforest is highly biodiverse and occupies almost 60% of Brazil's territory, mean it is at the centre of the national and international debate about the country's environmental policy -- and, to an extent, about its approach to development.

### Tipping point

Despite global interest, deforestation levels in Brazilian Amazonia have increased in seven of the past nine years, reaching 13,038 square kilometres in 2021, according to the National Institute for Space Research (INPE).

**Brazil: Annual deforested area in Legal Amazon (thousand km<sup>2</sup>)**



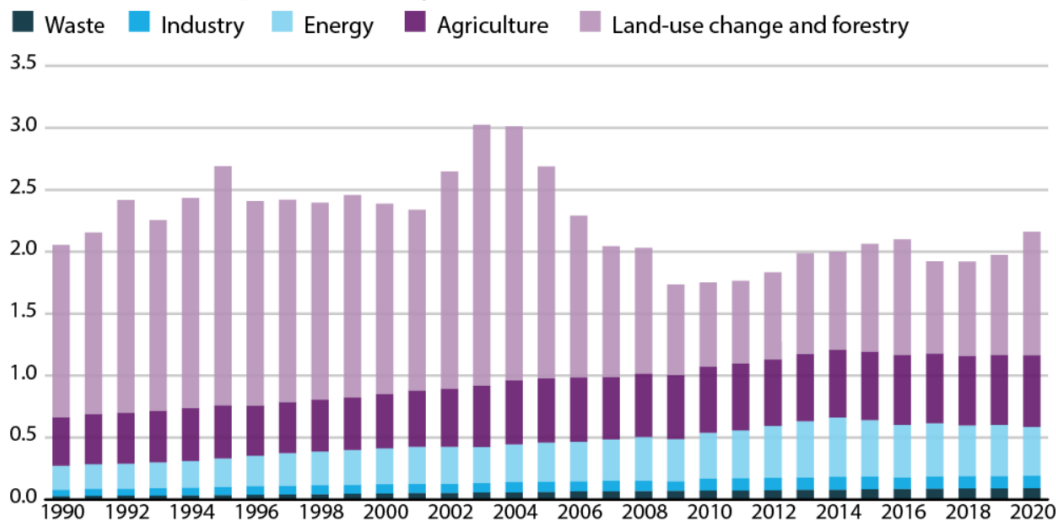
Scientists warn that the rainforest may soon reach a tipping point beyond which it will lose its ability to regenerate following degradation, even if deforestation stopped completely.

Studies indicate that Amazonia has, in fact, two such tipping points: a 4-degree Celsius increase in its temperature; and 40% of its area having suffered deforestation. If either of these thresholds is crossed, dry seasons will lengthen significantly, leading to large-scale transformation of the rainforest into savanna. This will happen especially in its southern and eastern sections, which are close to the Cerrado region, characterised by savanna-like vegetation.

However, the combined impact of the different drivers of change mean that, on current global warming rates, deforestation exceeding 20-25% of the rainforest would suffice to turn 50-60% of Amazonia abruptly and irreversibly into savanna.

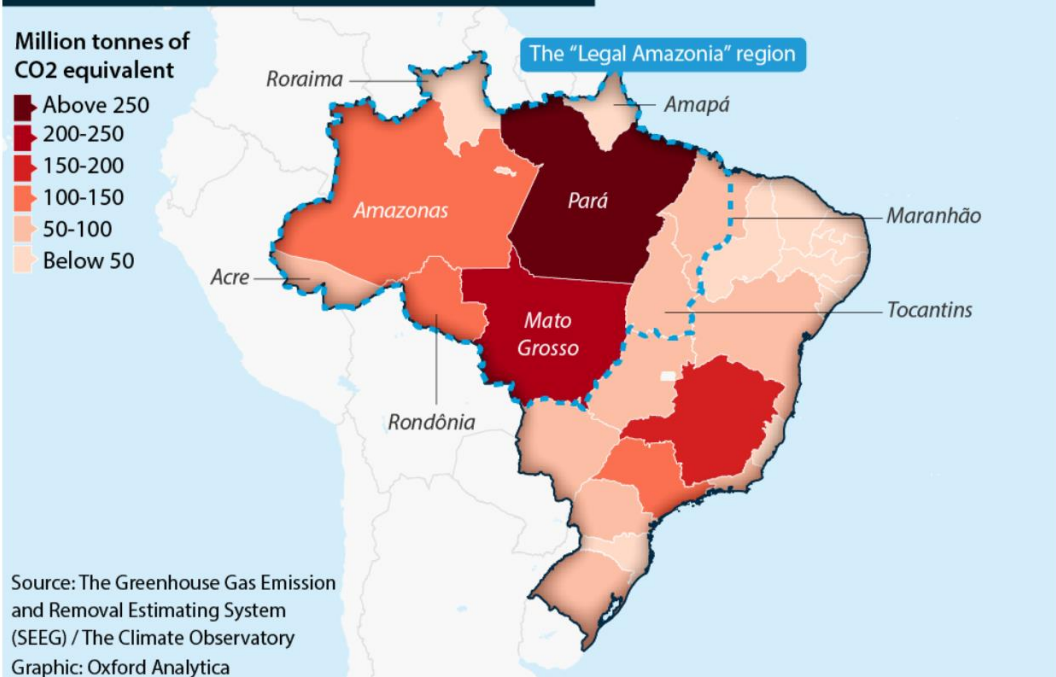
This process is further favoured by the fact that deforestation itself means more sunlight reaches the forest floor, making it drier and therefore more vulnerable to fires. With 15-17% of the rainforest already lost (some 20% of its Brazilian section) and accelerated deforestation, that point of no return is between two and three decades away.

**Brazil: Greenhouse gas emissions by sector (billion tonnes of CO2 equivalent)**



Source: The Greenhouse Gas Emission and Removal Estimating System (SEEG) / The Climate Observatory

**Brazil: Greenhouse gas emissions by state, 2020**



Source: The Greenhouse Gas Emission and Removal Estimating System (SEEG) / The Climate Observatory  
Graphic: Oxford Analytica

Recent related findings have increased scientists' alarm:

- Over 75% of Amazonia has lost resilience since 2000, meaning it takes more time to recover following droughts and wildfires.
- The eastern part of Amazonia -- around 30% of which has already been deforested -- emits about ten times more carbon than the rainforest's western areas, where deforestation rates are closer to 11%.
- Considering not just carbon dioxide but also other GHGs, parts of Amazonia may already have become net contributors to global warming.

Deforestation in Amazonia and other Brazilian biomes are a centuries-old process which has accelerated substantially in recent decades, and has been underpinned by policy decisions since the mid-2010s.

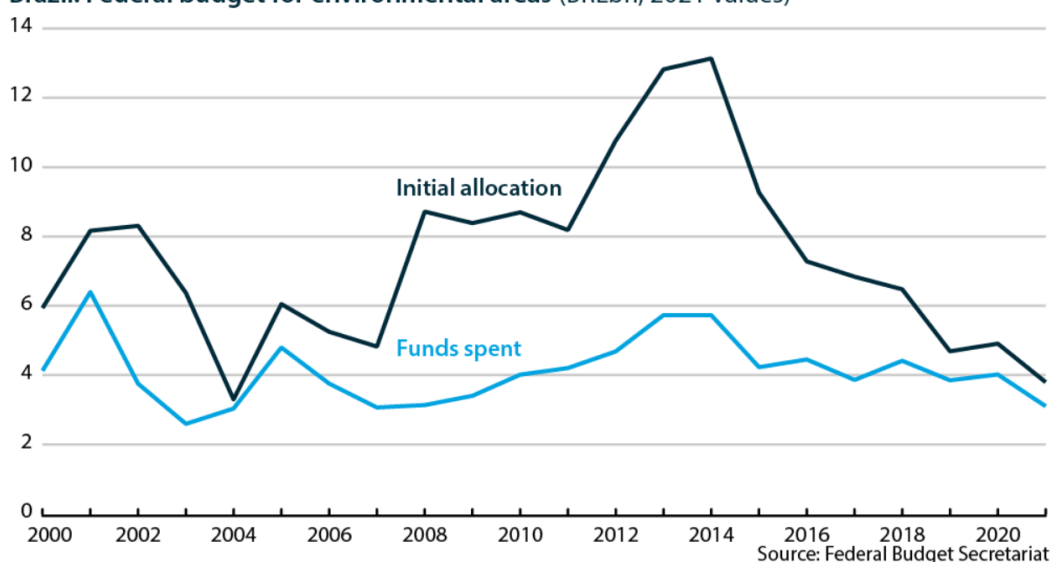
### Tighter budgets

Brazil's federal budget reveals the changing weight the government and Congress assign to environmental questions. Following years of rising budgets, resources allocated to environment-related areas dropped precipitously as the country entered a prolonged period of poor economic performance in the mid-2010s. Last year, allocated resources had collapsed by 71% from their 2014 peak.

The variation was still significant, but less pronounced in the case of the resources actually spent on this area. In this case, the drop in the same period was of 45%.

On average, the federal government spent only 60% of the resources committed to environment-related areas between 2000 and 2021. This record of poor execution suggests that environmental areas are a prime target for savings in the quest to achieve fiscal goals. Uncertainty over the actual availability of resources undermines the effectiveness of environmental policy, including joint action with civil society groups and the private sector.

**Brazil: Federal budget for environmental areas (BRLbn, 2021 values)**



In addition, Camila Rizzini Freitas, of the Federal University of Rio de Janeiro, and colleagues noted in a recent study that between 70% and 80% of the amounts from the environmental budget actually spent in 2005-21 went to the management of water resources. This includes financial resources dedicated to major infrastructure projects, so the amounts available for areas such as forest protection have been even lower than the headline figures suggest.

### Fiscal straitjacket

Fiscal austerity was written into the constitution by a December 2016 amendment meant to freeze spending in real terms for at least ten years. With over 90% of the budget earmarked to areas such as salaries, pensions and debt servicing, the squeeze has fallen primarily on discretionary spending, which dropped from 2.0-2.5% of GDP during 2008-14 to around 1.75% following the adoption of this 'spending ceiling'.

This has dealt a serious blow to environmental policies, which depend largely on discretionary spending for initiatives such as the acquisition and maintenance of equipment to carry out inspection and monitoring activities. Between 2017 and last year, the Ministry of the Environment saw a loss of 79.3% in its discretionary budget effectively spent.

Pressure over (and uncertainty about) environmental policies further increased with an additional 2021 constitutional change which triggers new spending caps when earmarked federal expenditure reaches 95% of the budget.

**Fiscal austerity has hit environmental budgets hard**

## "Termite infestation"

During his 2018 election campaign, Bolsonaro made clear his anti-environmentalist stance. In office, he has taken an approach to the area which Supreme Court Justice Carmen Lucia has described as a "termite infestation", with measures that eat away from within at the effectiveness of relevant institutions.

Policy insiders say that, for example, all key decisions at the Ministry of the Environment are now made by direct aides to the minister, while technocratic civil servants sit idle and the agencies' programmes remain stalled.

Bolsonaro's first environment minister, Ricardo Salles -- who lost his job last year amid a scandal in which he was suspected of helping timber traffickers -- encapsulated the government's approach to the area in a phrase he used in a cabinet meeting in the early days of the pandemic whose recording was later released after an unrelated judicial decision. In it, Salles said that the government should make the most of the media's exclusive focus on COVID-19 at the time to "run the cattle herd" -- that is, loosen restrictions by reinterpreting existing rules in processes that do not require Congress approval.

Such changes are often presented as modernising 'flexibilisations', but their actual effect is to favour illegal activity and encourage environmental destruction. For example:

- Process changes led to a 93% drop in the average number of fines paid for crimes involving vegetation in Amazonia in 2019 and 2020, compared with the previous four years.
- The reduction in paperwork required to export timber makes it easier for traffickers to hide its illegal origin, just as other policies are facilitating the activities of illegal loggers and are diminishing inspections. Last year, the Brazilian Institute of Environment and Renewable Natural Resources (IBAMA), whose powers include acting as environmental police, used only 41% of the resources available to this end.

In 2019, Salles sought to change the management of the Amazon Fund -- which received foreign resources to tackle deforestation -- leading Norway and Germany, its main donors, to suspend their transfers to it.

## Crime in Amazonia

Transnational crime has been present in Amazonia at least since the 1980s, when Colombian cartels used the Amazonas river as a cocaine export route. Nonetheless, the situation has escalated since the last decade, when groups including Brazil's largest criminal organisation, the First Capital Command (PCC) -- a major player in the world's cocaine trade -- also started to get involved in environmental crimes in the region. US Treasury Under-Secretary for Terrorism and Financial Intelligence Brian Nelson recently expressed concern over the PCC's links to illegal miners in Amazonia.

The fight to control trafficking routes has led to rising violence. It helps explain why last year Brazil's northern region saw a 7.9% jump in its homicide rate, in contrast with the national drop of 6.5%.

Illegal logging, fishing, poaching and even cattle ranching also fuel violence. Investigative journalist Allan de Abreu has found that the value of the hard wood from Ipe, a Brazil-native tree, multiplies by a factor of 89 in its journey from illegal extraction in Amazonia to its sale in New York -- five times more than the value of cocaine trafficked using the same route. Such exorbitant profits help finance more violence in the region.

At the same time, some of the arsenal of weapons currently deployed in Amazonia has, in fact, legal origins. This is notably due to the Bolsonaro government's measures to facilitate access to firearms, which have resulted in a 226% jump in gun registrations in 2019-21 in comparison with the three previous years.

Transnational criminal organisations are increasingly involved with environmental crime

Groups involved in illegal activities in Amazonia have also been emboldened by the president's bellicose anti-environmental narrative, which indicates that their actions are not just tolerated but also encouraged in the name of economic development.

### Indigenous populations

Studies have long shown the role of indigenous populations in protecting Amazonia. However, Bolsonaro has kept a campaign pledge not to demarcate additional territory as indigenous land.

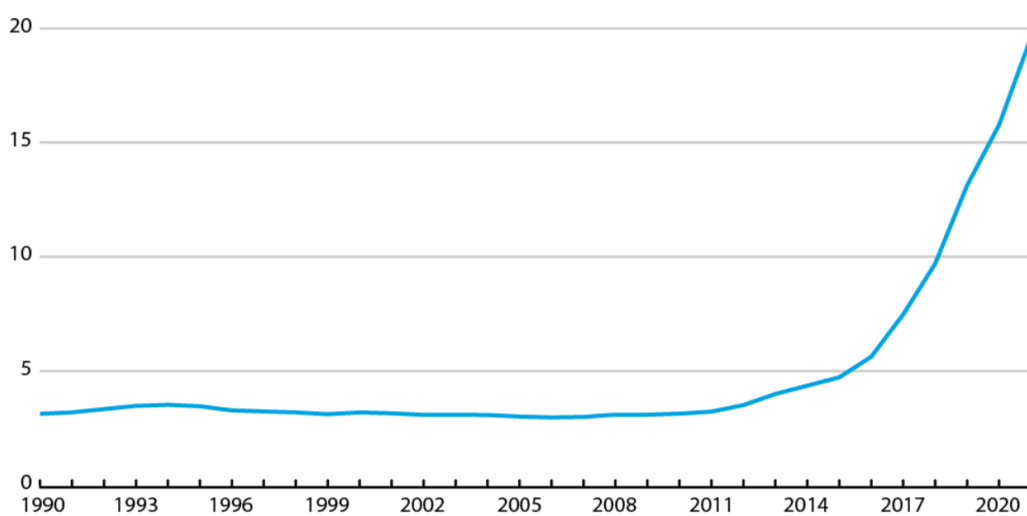
A case before the Supreme Court could restrict future demarcation to territory indigenous populations occupied when the current constitution was adopted in October 1988. This case sets up a confrontation between:

- on the one hand, Bolsonaro and the powerful agribusiness caucus in Congress; and
- indigenous peoples, who assert that this initiative ignores the fact that many had been forced to leave their lands, and highlight that their rights to these territories are guaranteed by the constitution.

Meanwhile, the National Foundation for Indigenous Peoples (FUNAI) in 2020 authorised farmers to obtain federal land registers for territory situated in non-demarcated indigenous lands.

Bolsonaro has for two years been pushing for a bill to allow mining and hydrocarbon exploitation in indigenous territory. While this has not passed yet, in recent years illegal mining in indigenous territory has soared, following a gradual increase since the early 2010s.

#### Brazil: Mining area in indigenous lands (thousand hectares)



Source: MapBiomas Project - Annual Land Cover and Land Use Mapping in Brazil - Collection 7

Environmental crime is fuelling an explosion in violence against Brazil's native populations. According to the Catholic Church's Missionary Indigenist Council, 305 invasions of indigenous land were recorded in the country in 2021, up from 109 in 2018.

### Looming elections

Former President Luiz Inacio Lula da Silva, who continues to lead most opinion polls ahead of the October 2 elections, has promised to tackle deforestation and end illegal mining in Amazonia if he is elected. He has indicated that he would strengthen IBAMA and the Federal Police and establish a ministry for native peoples, as well as proposing the possibility of subsidised 'green' loans for farmers planting grains and oilseeds on pastureland rather than deforested lands. Lula also recently told members of the

European Parliament that Brazil needs investment and technological partnerships with the EU in order to develop Amazonia without exacerbating environmental damage.

In practice, Lula's own environmental record during his 2003-10 term was widely questioned, although deforestation declined during that period. However, pushback against Bolsonaro's policies has been mounting both among international investors and importers of Brazilian goods, on the one hand, and Brazilian companies concerned about the impact on their exports on the other. Lula's message could thus gain some traction with both.



Oxford  
Analytica

First published in The Oxford Analytica Daily Brief, Sept 27, 2022

## Norway deal will help Indonesia reduce deforestation

Tuesday, September 27, 2022

Jakarta and Oslo have agreed a new partnership supporting Indonesian moves to cut forestry emissions

Indonesia and Norway signed a memorandum of understanding (MoU) earlier this month for a deal where Oslo will pay Jakarta to cut greenhouse gas (GHG) emissions from deforestation and forest degradation. The MoU comes just over a year after Indonesia terminated a similar pact with Norway. In October 2021, President Joko 'Jokowi' Widodo issued a regulation designed to help Indonesia achieve climate-related goals. However, this currently has no implementation guidelines.

### What next

Last year's presidential regulation will continue to lack impact in the absence of guidelines, but the renewed climate partnership with Norway should boost efforts to preserve Indonesia's forest cover. The two sides will be careful to ensure they avoid the kind of disagreement which led to the previous deal collapsing. Meanwhile, the Jokowi administration will continue to work on guidelines supporting the regulation.

### Subsidiary Impacts

- It may take several more months for the carbon tax mandated last year to come into effect.
- Jakarta will seek further external funding to support its action to mitigate the impact of climate change.
- Regular talks between the Indonesian and Norwegian environment ministers may help advance environmentally friendly policies.

### Analysis

Indonesia has the third-largest expanse of rainforest after the Amazon in South America and the Congo basin in Africa.

In 2010, it reached a deal with Norway in which Oslo promised up to USD1bn for reduced forestry emissions. Oslo said in 2020 that it would pay USD56mn on a USD5-per-tonne basis, having verified that Indonesia cut more than 11 million tonnes of carbon emissions in the 2016/17 forestry year (August-July).

On September 10, 2021, Indonesia terminated the agreement, citing a "lack of concrete progress" in payment.

The MoU signed on September 12, 2022, is for a new five-year collaboration.

Norway will make direct payments to the Indonesia Environment Fund (IEF). The first instalment will be the USD56mn previously promised. Whereas payments for the results achieved between 2016/17 and 2019/20 will be based on the existing 'measure-report-verify' protocol, those for 2020/21 onwards will be based on an updated protocol.

The MoU also provides for the Indonesian and Norwegian environment ministers to meet on a regular basis to discuss climate-related matters.

**USD56mn**  
The first payment which Jakarta should receive from Oslo

## Jakarta's commitment

The renewal of the partnership with Oslo shows Jakarta's commitment to stopping illegal slash-and-burn agriculture and protecting carbon-rich peatlands.

Indonesia has around 21 million hectares of peatland. The roughly 57 million tonnes of carbon held in it account for 55% of the world's total peatland carbon.

A moratorium on clearing peatland and primary forests was imposed under former President Susilo Bambang Yudhoyono in 2011. Jokowi made it permanent in 2019.

In 2015, forest fires mostly caused by slash-and-burn farming methods and exacerbated by the effects of the dry season left peatlands across the archipelago degraded.

Indonesia has managed to scale back deforestation in recent years. It reduced the annual rate of depletion to 115,500 hectares in 2019/20 from just under 1.1 million hectares in 2014/15 -- a reduction of almost 90%.

To some extent, the improved numbers reflect the fact that many regions now have less forest cover to lose. There was severe deforestation between the late 1990s and the early 2010s.

A recent study published in the Proceedings of the National Academy of Sciences says that Indonesia accounted for more than 58% of the global tropical deforestation caused directly by industrial mining between 2000 and 2019. Researchers found that more than 1,900 square kilometres of forest were cleared for industrial mining in that period.

The IEF supports the implementation of Indonesia's 'Forestry and Other Land Use Net Sink 2030 Operation Plan'. This is aimed at creating a major carbon sink.

Indonesia's enhanced 'nationally determined contribution' (NDC) to action against climate change, submitted to the UN Framework Convention on Climate Change last week, includes a commitment to reducing GHG emissions by between 31.9% and 43.2% from the business-as-usual scenario by 2030. The higher of the two targets is contingent on international support.

As part of its 'Long-Term Strategy for Low Carbon and Climate Resilience 2050', Indonesia hopes to achieve net-zero emissions by 2060.

External funding -- such as that which Norway will provide through the new emissions deal -- will be key. The national development planning ministry said last year that Jakarta would need to invest between USD150bn and USD200bn in low-carbon programmes by 2030 to reach its 2060 net-zero target.

## Key regulation

Reinforcing the October 2021 presidential regulation will be among the government's top priorities in the immediate term.

The regulation provides a legal framework for carbon pricing, where a cost is applied to GHG emissions so that businesses have an incentive to curb them. It paves the way for a system of carbon trading which should ease decarbonising pressures on business while helping Indonesia realise its NDC.

Days before the regulation was issued, the People's Representative Council, the main legislative chamber, passed a law mandating a carbon tax. The tax is yet to take effect and is unlikely to do so any time soon, given the pushback against the recent fuel price hike.

**90%**  
Reduction in  
deforestation  
levels between  
2014/15 and  
2019/20

Given the lack of implementation guidelines for the regulation, it is unclear what development projects require permission from the government. This is having an adverse impact on players looking to invest in various schemes.

The environment and forestry ministry is leading efforts to draft ministerial regulations linked to the presidential decree.

A major obstacle is the need for inter-ministry coordination: the environment and forest ministry needs to work with the ministries of energy and mineral resources, agriculture, finance and national development planning, and the coordinating ministry for maritime affairs and investment.

Luhut Binsar Pandjaitan, the coordinating minister for maritime affairs and investment, has insisted that his ministry be directly involved in policy initiatives linked to carbon pricing.

In June, the ministry issued instructions to create a dedicated steering committee. Luhut currently leads this. Airlangga Hartarto, the coordinating minister for economic affairs, is his deputy.

Of the dozens of bills on the priority list of legislation to be considered by the People's Representative Council this year, none relates to carbon trading.

Formulating ministerial regulations on the 2021 decree requires inter-ministry cooperation

Oxford  
Analytica

First published in The Oxford Analytica Daily Brief, Sept 14, 2022

## Water shortage is a major threat to China

Wednesday, September 14, 2022

Climate change will make China's chronic water shortage even worse in the years ahead

China's existing water insecurity is being aggravated by a heatwave and drought on a globally unprecedented scale. This will likely be a recurrent phenomenon, since it probably stems from climate change-induced changes in weather patterns. The Chinese government has limited means to address this problem's structural aspects. It will likely focus on ameliorating the symptoms through greater interventions in international hydrocarbon and agricultural markets and increased power generation from non-hydropower sources.

### What next

China is unlikely to abandon its climate change mitigation targets, but achieving these will require greater reliance on non-hydropower electricity sources. Unable to achieve food self-sufficiency, China will increase efforts to secure sources for importing certain agricultural commodities, affecting international markets. Combined with recurrent COVID-19 lockdowns, drought-related problems will increase pressure on China's role in international supply chains by giving manufacturers yet another reason to diversify.

### Subsidiary Impacts

- China will double down on investing in renewable energy technologies, increasing its influence in these industries globally.
- China's plans to subsidise its less-developed western and northern regions will become increasingly costly in net national terms.
- In a context of growing water deficits, Chinese management of river flows will aggravate tensions with downstream neighbours, notably India.

### Analysis

Water security has been a significant policy problem in China for decades. The nation's water resources are unevenly distributed, with northern China having sparse natural water flows compared to its dense population and industrial requirements. Rapid and poorly regulated industrialisation has polluted the nation's surface and subterranean water reserves. State media reported in 2014 that nearly 60% of China's groundwater was of 'relatively poor' quality or worse.

#### Heatwave

From June to August this year, much of China experienced a 70-day continuous heatwave with sustained temperatures above 40 degrees Celsius. In mid-July, 18 province-level regions simultaneously recorded temperatures exceeding 35 degrees. Some cities deployed water trucks to spray roads to reduce warping from the heat. Some experts have described it as the most severe heatwave on record globally, unprecedented in terms of intensity, duration and geographical range.

In late August, the government announced a nationwide drought warning. Mainly affected have been China's southern regions, which are intended to provide net water transfers to other parts of the nation through a massive south-north engineering project. Reduced

rainfall and increased evaporation in the watershed of the Yangtze River, China's longest watercourse and a transportation artery, have affected navigation and led to the lowest water levels since records began in 1865.

Persistently drier conditions raise doubts about southern China's capacity to compensate for the north's structural water deficit.

### Impact on tech

Drier conditions will undermine the 'Eastern Data and Western Computing' plan to boost development of China's laggard western provinces by locating power-hungry data centres there, to serve digital activity in China's economically advanced eastern provinces.

Changing climate causes particular problems where data centres have been located specifically to benefit from local cooling effects, such as in the mountainous and impoverished south-western province of Guizhou.

Drier weather may compound disruptions caused by China's zero-COVID strategy: as of mid-September, Guizhou's capital of Guiyang, where the data storage industry serves major digital technology providers including Apple, was under pandemic lockdown.

### Power shortages

China's southern and south-western provinces rely heavily on hydropower and export hydropower-generated electricity to the eastern provinces.

In mid-August, Sichuan province, which relies on hydropower for 80% of its energy usage, saw its hydropower generation capacity fall by half. The provincial government required factories to ration power usage, leading to reduced production or complete shutdowns, including by major foreign operators such as Volkswagen and Toyota. The shutdowns also affected global supply chain vendors such as Foxconn and CATL.

### Climate outlook

Climate scientists have speculated that slowing in the atmospheric jet stream over the earth's mid-latitudes has caused this year's summer heatwaves in China and elsewhere, an effect that will potentially recur seasonally for the long term. These effects are exacerbated by China's monsoonal rainfall pattern: the upper Yangtze basin normally receives half its annual rainfall in July and August.

### Food impact

Agricultural impacts will likely be significant. State media report that hundreds of thousands of hectares of crops are affected. China is a net food importer and became the world's largest agricultural importing nation in 2019. Rising income levels have increased per capita demand for food products.

The government is prioritising increased domestic production but has little prospect of achieving complete self-sufficiency, meaning that China will remain a significant factor in global food markets as climate change aggravates agricultural problems worldwide.

### Policy options

The government has few means to ameliorate persistent nationwide water deficits. Attempts to induce rainfall by seeding clouds with silver iodide may provide temporary localised relief, but are not adequate for chronic nationwide heatwaves.

Aggravation of China's already tenuous water security by climate change is one of the most serious threats to the nation's economic prospects and maintenance of its central role in international manufacturing supply chains.

Some areas have been hit by the heatwave and COVID-19 lockdowns simultaneously

Water shortage due to climate change is a major threat to the economy

China is likely to respond with larger international market interventions to obtain agricultural commodities and hydrocarbons for power generation. This may also imply continued Chinese demand for Russian hydrocarbon exports and continued construction in China of coal-fired power plants, reinforcing climate change effects.

### **International tension**

The reliance of South and South-east Asian countries on water flows from Chinese territory means that chronic droughts in China may inflame international tensions.

China has a poor record when it comes to addressing its neighbours' concerns about upstream dams that affect water levels in the Mekong, Salween, Ganges and Yamuna rivers.

As India's industrial activity grows, including power-hungry sectors such as semiconductor manufacturing, management of shared rivers is likely to add to tensions with China over disputed territory.

**CQ** First published in CQ News, Sept 7, 2022

## More battles over board seats seen with universal proxy rule

Sept. 7, 2022 – 12:24 p.m. By Ellen Meyers, CQ

Universal proxy cards, mandated this month for use for the first time in U.S. corporate board elections, are promising to spice up elections for contested director seats.

Gone are the blue and gold cards shareholders used for decades to vote for a single slate of board directors. As the Securities and Exchange Commission implements 2021 amendments to open up investor choice, public companies will have to use the new style of proxy card that allows investors to mix and match their votes instead of picking an entire slate backed either by company management or an activist.

With the change, the SEC's Democratic majority is aiming to embolden stakeholder capitalism, according to Michael R. Levin, an activist investor who is also board chair for Comarco Inc. and a director for AG&E Holdings Inc.

Shareholders will be able to calibrate their sentiments more precisely and vote for as much or as little change as they want, Levin said. Activist investors will benefit as shareholders gain new flexibility in changing a company's business strategy by ushering in independent candidates.

Companies' exposure to activist campaigns focused on environmental, social and governance issues and proxy fights is expected to rise, offering an easier path for investors like Engine No. 1, which got three of its candidates elected at Exxon Mobil Corp. last year by securing backing from major investors such as BlackRock Inc.

"We expect more activist projects and proxy contests, as all manner of investors will now consider running a [board of directors] campaign, such as ESG proponents or smaller shareholders that until now were content to seek support for a nonbinding proposal," Levin said.

The average number of votes against S&P 500 directors was already creeping up this year, while opposition to those filling certain roles, such as nominating and governance chairs, has about doubled in the past five years, according to professional services company Ernst & Young LLP.

"The degree of future board exposure to activist campaigns and proxy fights depends in part on the quality of connection between board nominating committees and the shareholder base," said Peter Gleason, president and CEO of the National Association of Corporate Directors. "If boards and nominating committees do not up their game, I believe that there will be a dramatic increase in proxy fights."

### The cost question

That could give corporate boards some growing pains. One of the biggest concerns will be the increased time and cost of more proxy fights, Gleason said in an email. The SEC, citing data from Factset, said the median cost for proxy fights is \$1.65 million for companies, but the price can range from \$65,000 to \$35 million. The median cost for dissidents is \$750,000.

Companies are concerned that universal proxy cards will make it easier for activists or other shareholders to get directors elected with little money or effort, said Melissa

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Sawyer, global head of Sullivan & Cromwell LLP's mergers and acquisitions group and co-head of its corporate governance practice.

The SEC requires investors seeking a vote for dissident candidates to inform the owners of at least two-thirds of the voting shares. But there have been questions about whether some may do the bare minimum to communicate an investment thesis and hope they can easily rally disgruntled investors to support their candidates, Sawyer said.

"That's the fear. Whether it actually plays out that way, I'm not sure," she said in an interview.

The country's top proxy advisory firms, Institutional Shareholder Services Inc. and Glass, Lewis & Co., broadly applauded the SEC's changes. ISS and Glass Lewis said in separate client notes that universal proxy cards increase the strain on corporate boards' weakest links.

However, both firms argue that the effect on director elections will be nuanced. While there will be more interest from corporate gadflies to shake things up, activist investors also will have to avoid weak links on their slates and become more strategic in picking who and how many they will nominate.

"It is possible that some shareholders may run ESG-centered contests marketed to this 'upgrade urge,'" ISS said. "Campaigns purely focused on ESG issues would appear to be better suited for proxy access, rather than proxy fights. After all, an economic activist simply 'weaponizing' ESG issues is far less compelling than a significant long-term shareholder, concerned that companies are not appropriately focused on their long-term challenges, seeking board representation."

Companies and shareholders are unlikely to realize the full impact of universal proxy cards until the next proxy season starting in late spring, Sawyer from Sullivan & Cromwell added.

"I really don't think we're going to know the answer to that until we've actually been through a few cycles of annual meetings where someone has used universal proxy," she said. "I don't even think we'll know in 2023. We'll just have a few data points probably, but not enough to draw any real conclusions from it."



Oxford  
Analytica

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## Some US states are passing anti-ESG legislation

Friday, September 30, 2022

Some Republican states are using laws to discourage aspects of environmental, social and governance (ESG) policies

On September 11, Florida Governor Ron DeSantis again accused some large US companies of attempting to shift public policy away from the Republican agenda. Some energy-producing states under Republican control are advancing legislation that restricts environmental, social and governance (ESG) constraints on fossil fuel and firearms companies. Yet shareholders are showing little inclination to move away from ESG policies. This suggests further tensions ahead between senior executives and leading Republicans.

### What next

Populist criticism of corporate 'wokeness' will continue until November's midterm elections but the financial cost to states of passing anti-ESG laws may become more apparent after that. The longer-term momentum of anti-ESG efforts will depend in part on the extent of Republican control in Washington. For example, a Republican president who is ready to undo Biden's energy transition agenda would support limits on the environmental dimension of ESG policies.

### Subsidiary Impacts

- Banks will be a target for states as their provision of credit gives them significant influence over corporate ESG policies.
- Criticising big business may help Republican outreach to Hispanic voters, who own a growing share of US small businesses.
- Other states will follow Texas in expanding anti-ESG protections, from fossil fuel companies to firearms makers and retailers.

### Analysis

Parts of the private sector have been drawn into the political 'culture wars' by three trends: the Republican preference to legislate social issues at the state level, where they dominate; the politicisation of business regulation, most immediately around ESG issues; and deepening political polarisation which, new research suggests, is even more intense in the C-suite (the most senior level of management) than the general population.

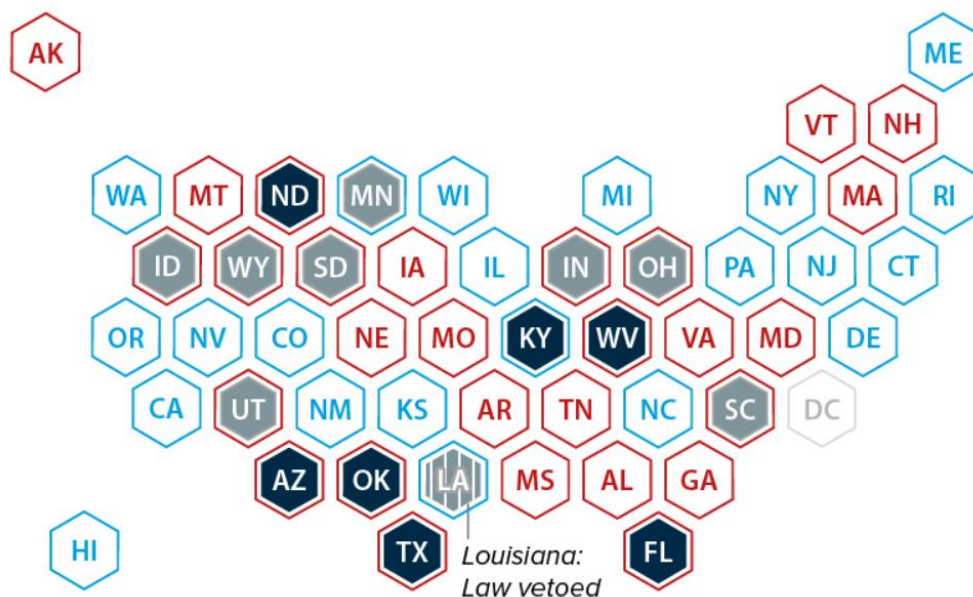
### States against ESG

Republican-controlled energy-producing states see a connection between two developments. One is that companies in the fossil fuels sector are finding it more difficult to secure bank credit, and are paying more when they do; the other is that the implementation of ESG principles in the financial sector is increasing. Their conclusion is that adherence to ESG policies constitutes a de facto boycott of their states' fossil fuel companies. Republicans are responding by introducing anti-ESG legislation.

Five Republican-controlled energy producing states -- Texas, West Virginia, Kentucky, Oklahoma and North Dakota -- as well as Arizona and Florida have already adopted anti-ESG laws that exclude banks and investment funds with certain ESG policies from public finance contracts in the state. Louisiana's Democratic governor vetoed similar legislation passed by its Republican legislature. Several other states have anti-ESG legislation pending.

### United States: Anti-ESG legislation by state (as of end-September 2022)

Anti-ESG law on fossil fuels: ■ Passed ■ Pending State Governor: ○ Democrat ○ Republican



*Louisiana: passed by legislature but vetoed by governor*

*Texas: also passed anti-ESG law on firearms*

*Florida: general proscription on pension funds from considering ESG factors in investment decisions*

Source: Morgan Lewis

States are already using this legislation. In July, West Virginia proscribed five banks for violating its law. In August, Texas excluded ten banks and investment companies, including a leader in ESG investment, BlackRock, from financial work for the state.

#### Pension funds

States oversee large pension funds because public-sector workers such as teachers and police are hired on a state and local level. Some are using that authority to impose anti-ESG provisions on asset managers and advisers.

In August, Florida updated its investment rules for state pension funds to require them to evaluate investments based on 'pecuniary factors [that] do not include the consideration of the furtherance of social, political, or ideological interests', a phrase aimed at ESG.

The wording and intent mirror the 'Trump ESG Rule'. This was issued by the Department of Labor in the Trump administration's final days and applies to most private-sector retirement and health plans under the 1974 Employee Retirement Income Security Act (ERISA). The Biden administration announced shortly after taking office in January 2021 that it would not enforce the Trump ESG Rule.

#### Underwriters walk

While it may be politically popular with some constituencies, using access to state contracts as leverage over financial firms can have costs.

In Texas, anti-ESG laws led to the exit of five of the largest municipal bond underwriters from the state. Research led by Daniel Garrett of the Wharton Business School at the University of Pennsylvania estimates that the decline in underwriting competition will cost Texas between USD303mn and USD532mn in additional interest payments on the state's USD32bn of debt in the first eight months after implementing its anti-ESG law.

The Securities and Exchange Commission (SEC) is checking for firms that have simultaneously declared compliance with the Texas laws and included ESG disclosures in their SEC filings. This could open them to charges of misleading investors and could encourage more exits from states that pass anti-ESG legislation.

**In Texas, anti-ESG laws have cost the state money**

## Politicised regulation

The Biden-appointed SEC chair, Gary Gensler, has supported the Democrats' climate change agenda by advancing rules that require public filings to include more detailed corporate disclosure of climate-related risks and greenhouse gas (GHG) emissions. The SEC is also considering additional mandatory disclosures on other facets of ESG.

As a regulatory and rulemaking authority, the SEC is independent from the White House. However, the gap between such agencies and the agenda of presidential administrations has been narrowing in recent years as legislative gridlock in Washington forces presidents to make greater use of executive orders and agency rules to affect policy.

## Sources of tension

Republicans have multiple reasons to undermine ESG policies. These include providing support for the fossil fuel and firearms industries, which are popular with the party's core constituencies and are perceived as under attack from Democrats. Another factor is the party's long-standing pursuit of deregulation. In addition, Republicans in general, and Trump loyalists in particular, now see regulation as the Democratic political agenda continued by other means.

The list of companies that have been called out for pursuing a liberal agenda of 'woke capitalism' is surprisingly diverse. It includes Coca-Cola, Citigroup, Cisco, Delta Airlines, Disney, Merck, JPMorgan Chase, UPS, Walmart and even Major League Baseball. This suggests that the tension is more about Republican politicians wanting to stop large, high-profile companies from being critical of their policies rather than a fundamental ideological split over capitalism.

## C-suite polarisation

The shift in attitude may not be exclusively on the Republican side. Research from the Harvard Business School, published in July, found that while the ratio of Republican-registered executives to Democrat-registered executives in US-listed companies remained roughly constant at just over 2:1 between 2008 and 2020, executive teams have become increasingly polarised.

In other words, companies today are more likely to be led by teams of executives that are either predominantly Republican or Democrat.

This reflects a broader trend of US individuals associating with the politically like-minded but suggests that this is happening more intensively in the C-suite than among the general population.

C-suites appear even more polarised than the general population

## Avoiding common cause

The pressure on chief executives from their stakeholders to take more public positions on social issues has occurred in parallel with the rise of populist Republicanism. As executives speak out, this has enabled Republicans to condemn businesses for following an excessively liberal agenda that, they argue, has little to do with business requirements.

However, the fact that there has been no attempt by populist Republicans to make common cause with progressive Democrats -- whose agenda includes efforts to place limits on dominant tech companies and higher taxes on large corporations -- implies that the Republican schism with parts of the private sector is tactical rather than strategic. As such, it is primarily about silencing criticism rather than combating industry concentration.

Oxford  
Analytica

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## US companies reassess China risks

Thursday, September 1, 2022

An annual survey of US companies operating in China shows that multinationals are reviewing their strategies

The annual survey of US companies conducted by the US-China Business Council was published on August 29. As the survey suggests, the worsening of US-China relations, particularly over Taiwan, together with COVID-19-related supply chain disruption and Western political pressure to disengage from China, has prompted multinationals to reassess their Chinese business risks. Many firms are looking to lighten their China footprint but those already committed to the Chinese market will stay.

### What next

The Chinese Communist Party Congress in October and US midterm elections in November make any near-term improvement in US-China relations unlikely, elevating reputational, policy and legal risks for Western companies. Multinationals will not be able to disengage their supply chains from China's manufacturing prowess easily or quickly, but will construct supplementary links where they can. Decoupling of the two economies will be slow and fragmented, with large variations by and within sectors.

### Subsidiary Impacts

- It is not China's manufacturing capacity that companies will find difficult to replace, but its manufacturing expertise at scale.
- December's holiday retail season will give Western CEOs an excuse to disengage from China if supply chain problems hurt sales.
- Western multinationals face a growing risk of criticism from customers and employees for their business activities in China.
- Russia's war against Ukraine raises the risk that China could be caught up in Western sanctions against Russian companies.

### Analysis

The geopolitical risks of China-related business for multinational companies in the context of deteriorating US-Chinese relations were given additional urgency by Beijing's belligerent response to US House Speaker Nancy Pelosi's visit to Taiwan in early August.

Military exercises by the People's Liberation Army (PLA) following Pelosi's visit disrupted commercial shipping around Taiwan and underscored the need for contingency plans for a serious blockade of the island or, worse, an invasion.

Further PLA live-fire drills close to Taiwan followed the mid-August visit of a delegation of US lawmakers. The Biden administration's increasing support for Taiwan and a more unequivocal pro-Taiwan stance from both parties in Congress will keep relations between Beijing and Washington and its allies tense.

The annual survey by the US-China Business Council, whose members include companies with long experience of operating in China, was conducted before the Pelosi visit but reflects serious concern about Beijing's zero-COVID policy and other issues.

Optimism about the future is at a record low, while three-quarters of respondents cite geopolitics as the factor exerting the most impact on their five-year outlook.

## Sourcing and supply chains

The risks for companies selling into China, the world's second largest economy, differ from those which see China as primarily a supply chain source.

### Selling into the Chinese market

Multinationals selling into the Chinese market, and thus with local operations, have long been at risk of arbitrary punitive measures that can range from non-routine tax inspections to 'spontaneous' patriotic consumer boycotts of their products.

They must now navigate the additional challenges of China's new data export regime that come into effect today, September 1, on top of the impacts of Beijing's drive for industrial self-reliance in key sectors, Western human rights sanctions over Hong Kong and Xinjiang, growing anti-Western cooperation between Moscow and Beijing, and even the fear of executive hostage-taking.

### Separating out China operations

In current conditions, a handful of companies may choose to exit the China market. Yet foreign firms selling into the Chinese market and producing locally have little choice but to continue investing in their China operations, including their inbound supply chains, if they want to remain committed to the market.

Many of these companies will either separate their China business from their other global operations to the extent that they can, or lighten their local footprints for assets and expatriate staff using a number of options. These include switching from an ownership structure to a distributor relationship; licensing products, technology and brands to a Chinese company; and localising any remaining owned operations.

Companies with outbound supply chains from China are starting to develop parallel links outside the country in a move that supply chain managers refer to as 'China plus one', although some are finding that experience in China's tightly controlled business environment has little application elsewhere.

Small and medium-sized US companies selling low-cost consumer goods primarily in the US market are in the vanguard of those leaving China altogether, switching to suppliers elsewhere in Asia or 'near-shoring' in countries such as Mexico.

### Producing in Vietnam

A few multinationals have the capacity to segregate their supply chains regionally and the expertise to manage them. Apple, Google, Dell and Amazon are among the US tech giants expanding production in Vietnam to establish supply chains outside China, as textile and apparel producers did before them.

The Taiwanese contract electronics manufacturer Foxconn, which has extensive operations on the mainland assembling consumer electronic products for US multinationals, has started test production of Apple Watches in northern Vietnam. If it proceeds to full production, this will be the first time the devices will have been manufactured outside China, although Apple has sourced AirPods earphones in Vietnam and plans to make iPads there.

Foxconn is also expanding its production facilities in India, where it will build some of Apple's new iPhones for the US market.

### Expanding Chinese factors

Some of the largest tech multinationals will have to walk a fine geopolitical line between lowering their dependence on making products inside China for export markets and using China-based firms such as Luxshare, BYD and Huaqin to do so.

The expansion of such firms overseas, particularly into Latin America, will expand China's economic sphere of influence and sustain its dominance as the global manufacturing hub.

Some companies are adopting a 'China plus one' strategy

## Decoupling

Capacity constraints in third countries, from skilled workforces to regulatory regimes and secondary suppliers, will also limit the speed at which the supply chain transition can proceed.

So far, this is most visible in capital markets and technology, where policy is a driver. Washington and Beijing are both pursuing nationalist industrial policies in technology, although China's struggles to develop an indigenous chip industry illustrate the difficulties of a clean separation.

## Climate issues

Climate change also complicates supply chain risks. This summer, a severe drought and heatwave in south-west China has impaired hydropower generation along the middle reaches of the Yangtze River, requiring electricity rationing that has disrupted industrial production in Chongqing and the surrounding Sichuan province.

VW and Toyota are among multinationals that have had to shut down plants temporarily. Foxconn, which assembles iPads in Chongqing, was also affected. Tesla temporarily shut its electric vehicle factory in Shanghai because low water levels prevented components being shipped down river from Chongqing.

Shanghai, like the rest of China's low-lying eastern seaboard, is also at increasing flood risk from rising sea levels because of global warming,

## Outlook

US-China relations are now at a point where both are adopting policies to limit the business that one country's firms can do in the other.

The largest global multinationals will continue to rely on China for manufacturing, supply chains and markets. They will be able to split supply chains and ride out an extended period of deteriorating relations, perhaps lasting years. Those options are less available to most other foreign firms.

Climate issues are adding to supply chain risks