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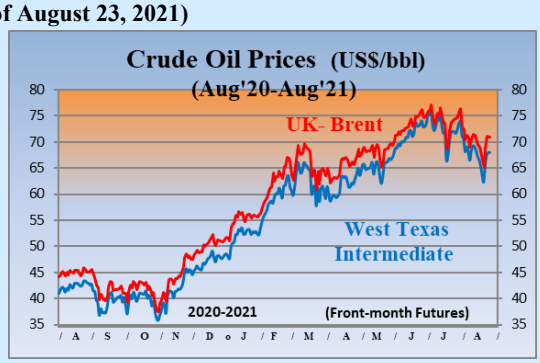
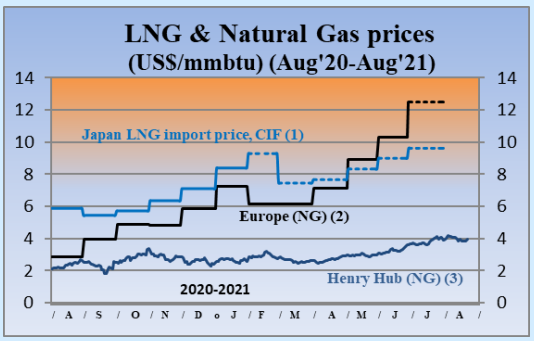
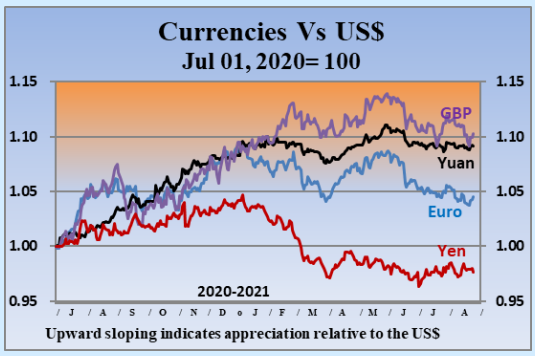


Sources:
(1) DOE-EIA
(2) Investing.com



Sources:
(1) Ministry of Finance "Japan Trade Statistics"
(2) World Bank (Netherland Title Transfer Facility)
(3) DOE-EIA, NYMEX (Front-month Futures)



Source: x-rates.com

Sources:
(1) Finance. Yahoo.com
(2) Investing.com

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Facing mounting criticism of the Putin government inside the country and a prolonged stand-off with the West outside, Russia urgently needs to deploy a new energy strategy in line with the international trend toward decarbonization.

1. US: Increasing Uncertainty over Infrastructure Investment Plan and Mining Policy on Federal Lands

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In Congress in the US, the infrastructure investment bill, which includes repairing and upgrading domestic infrastructure and decarbonization measures, is having a rough passage and negotiations continue. On June 24, 21 bipartisan Senators and President Biden reached a framework agreement on the bill. However, on July 21, a move to start debating the bill was rejected in a Senate vote due to lack of support from the opposition Republican Party, which is concerned about the plan's funding source.

Many consider that the bill faces an uncertain future even if the floor debate would begin, given the lack of support for the framework agreement not only among the Republican Party but also within the ruling Democratic Party. The framework allocates $312 billion for decarbonizing transportation infrastructure including the construction of charging points for electric vehicles (EVs) and electrifying buses, and $73 billion for building clean power infrastructure, in addition to public investment for infrastructure including roads, bridges, and airports. However, progressive Democrats are increasingly dissatisfied with the bill after some key measures were removed from the President's original plan, including expanded support for education and childcare and, regarding decarbonization, the clean electricity standard (CES), which requires power producers to introduce carbon-free power sources. Various adjustment efforts and political approaches are being considered as the Congress recess that starts on August 2 approaches, but the Biden administration's trademark infrastructure investment and clean energy bill continue to face the challenges of domestic politics.

Meanwhile, for those decarbonization measures that only require administrative procedures to implement, the Biden administration is set to advance them steadily, separately from those requiring legislative procedures. Michael Regan, Administrator of the Environmental Protection Agency, has indicated that a new automobile fuel standard will be announced within a few weeks and a domestic methane emission standard by around September this year.

At the state level, opposition against the Biden administration's decarbonization policy is growing. The southern state of Louisiana has filed a lawsuit to block the January executive order that halts new leases for exploration acreages on federal lands; it is one of thirteen oil-producer states to do so along with Texas, Oklahoma, and Alaska. On June 15, a Louisiana federal district court granted the claim and ordered the federal Department of the Interior to open up the lands for exploration. The Department is reportedly formulating a policy for mining on federal lands in response to the January executive order. While the court ruling may ease the Department's policy towards mining on federal lands, the Department may open up the lands but effectively freeze mining by changing the rules to shorten lease periods and require rigorous environmental assessments. The domestic oil industry is paying close attention to the upcoming release of the Interior Department's policy on exploration on federal lands as an indicator of the Biden administration's political stance toward the industry.

2. EU: Policy Package for 55% Reduction by 2030 Unveiled

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On July 14, the European Commission unveiled the draft version of "Fit for 55," a policy package to achieve its goal of reducing GHG emissions by 55% from 1990 levels by 2030. The policy package takes a multifaceted approach, combining "carrot and stick" and consisting of multiple amendments and the establishment of new systems. Key highlights of the policy are as follows.

First is the strengthening of the EU Emissions Trading System (EU-ETS). For the areas already covered by the system, raising the reduction of emissions caps is being proposed. In the aviation area, free emission allowances will be phased out to align with the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA). Further, maritime transport, which has been out of scope of the EU-ETS to date, will be incorporated into the system in stages from 2023 to 2025. For maritime transport and aviation, a mandatory requirement to supply sustainable air fuel (SAF) and caps on the CO_2 emission intensity of energy sources for ships will be introduced, as well as rules requiring the supply of clean electricity to seaports and airports. Meanwhile, for road transport and buildings, which are currently outside the scope of EU-ETS and are difficult to address as it requires the public to take action, a new emissions trading system will be set up for fuel suppliers in 2026. Simultaneously, a mechanism will be implemented to encourage the market to change. Specifically, for road transport, Fit for 55 will impose tougher requirements for CO_2 emission reductions, namely a 55% reduction from 2021 levels by 2030 and a 100% reduction by 2035 (zero-emission), and will revise the alternative fuel infrastructure regulations in order to urge member states to upgrade and expand their clean energy supply infrastructure for automobiles. For buildings, the Energy Efficiency Directive will be amended to set more ambitious obligations to reduce energy consumption. In the public sector, renovation of 3% of public buildings will be required each year to also create jobs.

Second is the introduction of the Carbon Border Adjustment Mechanism (CBAM), whose aims include preventing carbon leakage (relocation of emission sources to countries with lower carbon emission costs) resulting from enhancing climate measures, and preventing the loss of competitiveness of EU industry. The free emission allowances of EU-ETS, which are currently serving these purposes, will be phased out and replaced by industry protection through CBAM. It is stated that the aim of CBAM is not only to protect EU industry but also to urge other countries seeking to export goods to the EU to take climate action as a secondary effect. Since the purpose of CBAM is to level the playing field for industries of the EU and other countries, the tariffs imposed on imports must match the carbon costs that arise under the EU-ETS. This requires tracking how much carbon was emitted in producing the imported product, and therefore it will be necessary to confirm that this is technically feasible for each of the five types of products in the original plan, including cement. CBAM will undergo pilot testing from 2023 through 2025 without tariffs and will be launched fully in 2026.

The policy package also includes wide-ranging proposals including raising the share of renewables in the 2030 energy mix to 40% from the current 32% and increasing the minimum tax rate for heating and transport fuels. The course of the EU's challenge deserves attention.

3. China: The World's Largest National Emissions Trading System Goes Live

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China is aiming to reach net-zero carbon emissions before 2060. To achieve this goal efficiently, China has established a national market for emissions trading, which began trading on July 16.

The introduction of an emissions trading system was first mentioned in the Resolution on Actively Responding to Climate Change adopted by the National People's Congress (NPC) Standing Committee in August 2009, some 12 years ago. Subsequently, regional trading markets were launched in seven regions including Beijing and Shanghai in 2013 as a pilot project. The Ministry of Ecology and Environment (MEE), the general governor of China's climate change administration, has announced that the seven markets have traded credits for 480 million tonnes of emissions (in carbon-dioxide equivalent) worth 11.4 billion yuan (1 yuan ≒ 17 yen) by the end of June this year. The MEE went on to praise the pilot trading market project for effectively promoting emissions reduction efforts by applicable companies and laying the foundation of the national trading market.

China's first national carbon emissions trading market was initially opened to address the electricity sector, which accounts for 40% of the country's CO_2 emissions. According to Xinhua News Agency, the market covers 2,162 power producers, including those producing electricity for their own use, with emissions of at least 26,000 tonnes per year. The applicable power producers collectively generate some 4.5 billion tonnes of emissions. The trading market covers the largest amount of emissions in the world, more than 2.2 times that of EU-ETS which trades approximately 2 billion tonnes. The system works as follows. The government sets quotas for the amount of emissions by each applicable company, and any company that generates more emissions than its quota must buy quotas from others in the market in the form of credits. The quotas are settled every fiscal year, and any shortfalls will be deducted from the following fiscal year's quotas. Continued non-compliance will eventually result in having zero quotas, meaning the end of business. Emission quotas are being distributed without charge for now but will be for sale in the future. The scope of target industries is due to be expanded by 2025 to include eight industries with sizeable emissions, including steel and construction materials.

Nationwide trading is conducted centrally at the Shanghai International Energy Exchange, which ran the pilot project. On the first day, the opening price was 48 yuan/tonne, the closing price 51.23 yuan, the lowest price 48 yuan, and the highest price 52.8 yuan, and the transaction volume was 4.104 million tonnes worth 210 million yuan, with an average price of 51.23 yuan. 4.833 million tonnes were traded in the six business days up to July 23, meaning that the total transaction volume for the five days after the first day was just 729,000 tonnes, with an average of 146,000 tonnes per day. The average five-day transaction price excluding the first day was 54.87 yuan, up 7% from the first day average price, and the closing price on July 23 was 56.97 yuan, up 11% from the first day closing price. Since there was a certain amount of trading from the first day and prices did not fluctuate wildly, the national trading market is considered to have made a solid start. Incidentally, the trading price in EU-ETS was mostly below 10 euros from 2012 to around 2017 (1 euro ≒ 130 yen) but the price surpassed 50 euros as of late May this year.

Net-zero carbon emissions is unachievable without decarbonizing the power sector. It is hoped that the introduction of the emissions trading market for the power sector will eliminate thermal power plants having a high emission intensity, help decarbonize the generation mix, and minimize the total cost of reducing carbon arising from power generation. It is also expected to serve as a model case for expanding the market to other sectors. The trading price will also be deemed as the principal basis for the carbon tax rate, currently being considered for small emission sources to complement the emission trading market. In terms of foreign relations, the national emissions trading market also aims to mitigate the impact on China of the Carbon Border Adjustment Mechanism (CBAM), which the EU is scheduled to launch. Developments in national emission credit trading deserve close attention.

4. ME: Deadlock in Forming a Cabinet in Lebanon

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Senior Analyst
JIME Center

On July 15, Lebanon's Prime Minister-designate Saad Hariri announced that he would give up forming a government and step down. Former Prime Minister Hariri was designated as the new PM in October 2020 after the Diab government resigned to take responsibility for the escalating anti-government rallies that erupted after the Port of Beirut explosion in August 2020. Hariri had focused on economic reforms and eradicating corruption, and had been planning a cabinet of mostly technocrats to gain support from the international community, including Lebanon's former suzerain, France. However, Lebanon has a unique power-sharing mechanism in which political posts and public offices are allocated among the 18 recognized religious sects (the post of president goes to the Maronite Christians, the prime minister to the Sunna Muslims, and the speaker of the parliament to the Shia Muslims), and the allocation of posts among the religious sects takes priority in appointing members of the cabinet. President Aoun had asked PM-Designated Hariri to change the allocation of posts among sects and the selection of individuals but the two failed to find a middle ground, resulting in the PM-Designate stepping down.

Lebanon declared default on foreign-currency-denominated government bonds in March 2020 but the situation has since worsened due to the pandemic. The country has been hit by social and economic crises such as escalating inflation, rising poverty, a sharp fall in its currency, power cuts due to lack of funding, and rallies and riots. The government of Lebanon has long failed to make key political decisions and has become dysfunctional due to the political power-sharing. The current crisis is a consequence of the dysfunction; Lebanon's problems are unlikely to resolve themselves even when a government is formed. Without a government, however, the country has little chance of getting support from other countries. The situation is set to worsen, with no sign of any solution.

Meanwhile, in Iraq, where the government also has serious governance issues, a power cut occurred when the mercury topped 50°C, resulting in the Electricity Minister, Majid Mahdi Hantoush, stepping down. Some governorates suffered power cuts for several days from the end of June to early July due to disruptions in electricity imports from Iran, terrorist attacks on transmission towers, and technical issues. The situation has since improved, but the gap between supply and demand is becoming chronic—the peak summer demand reached 29 GW but peak supply is less than 19 GW—fueling frequent anti-government protests. The government has established policies such as reducing the flaring of gas and collecting more associated gas, and connecting its power grid with those of Kuwait and other Gulf countries, but progress is slow due to corruption, lack of administrative competence, and complex bureaucracy. Meanwhile, the healthcare system has collapsed and is in a dire state. On July 12, poorly-managed oxygen cylinders exploded one after another in a ward for coronavirus patients, killing more than 90 people. In a country with chronic government dysfunction, incidents such as these are likely to be repeated.

5. Russia: Putin Government Takes on the Low-Carbon Era amid Domestic and Diplomatic Woes

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The coronavirus case count, mainly of the Delta variant first discovered in India, is soaring in Russia as well. The cumulative count surpassed six million (with approximately 150,000 deaths) as of July 20, and the situation is the worst among European and former-Soviet countries. On June 30, President Putin stressed the safety of the Russia-made vaccine Sputnik V and called for understanding for introducing mandatory vaccinations at the municipality level. However, the public strongly distrusts the Putin government which only discloses limited information about the domestic vaccine; barely 20% of the population has been vaccinated as of mid-July. With GDP shrinking by 0.7% year-on-year in Q1 2021 and the May disposable income reducing by 3.6% year-on-year (Federal Bureau of Statistics), public frustration will intensify if the pandemic situation worsens.

On July 2, President Putin approved the National Security Strategy which was revised after some six years. The document condemned the United States and the North Atlantic Treaty Organization (NATO) for interfering in Russia's internal affairs and placing the country under siege through economic sanctions and cyberspace, and stated that it was ready to confront and retaliate. In the article "On the Historical Unity of Russians and Ukrainians" written by Mr. Putin and published on the Kremlin website on July 12, he stressed that partnership with Russia is a prerequisite for the true sovereignty of Ukraine. Ukraine immediately spoke back, arguing that the Ukrainians and Russians are "two different peoples." Europe and the United States, which have been imposing sanctions on Russia for some seven years now since the annexation of Crimea, fear that President Putin may harden Russia's foreign policy to divert attention from the growing public criticism against the government.

In mid-July, US Special Envoy for Climate John Kerry visited Moscow for three days and had talks with Sergei Lavrov, Minister of Foreign Affairs, and Ruslan Edelgeriyev, Russian Special Presidential Representative on Climate Issues and Adviser to the President of Russia. The US-Russia joint statement released on the 15th stated that the countries recognize the need to address the worsening climate challenge with seriousness and urgency, and are committed to the robust implementation of the Paris Agreement and the success of COP26 scheduled for November 2021. Amid the prolonged confrontation between the two countries, climate change has become an area where the two countries can explore a diplomatic middle ground.

Meanwhile, with over 50% of total exports coming from oil and gas, Russia is becoming alarmed as more countries head toward decarbonization. In its May 2021 report titled "Carbon border adjustment mechanism in the EU: risks of discrimination for Russian exporters," the Institute for Natural Monopolies Research, a private research institute based in Moscow, estimates that Russia may lose up to $2.2 billion/year due to the carbon border tax. Some domestic experts argue that the losses will be $5–6 billion. Amid growing global attention on the use of hydrogen, the Russian Ministry of Energy has formulated a hydrogen development strategy toward 2024 and is awaiting final government approval. Russia is reportedly planning to increase hydrogen exports to 7.9–33.4 million tonnes by 2050. As political and diplomatic confrontation with the West continues, attention must be paid to Russia's energy strategy in response to the decarbonizing international community.

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