

June 2023

E, S, Geopolitics

Over the past two months, we have witnessed several developments (both here in the U.S. and abroad) highlighting the increasing relationship between geopolitics, issues surrounding climate change and industrial innovation, and ESG. In this report, we explore how the recently proposed bi-partisan U.S. Senate PROVE-IT Act, the EU's package of regulations, interest in ocean floor mining, and the potential for increased climate-related conflict are being used as instruments to direct national power via diplomatic, informational, military, and economic means.

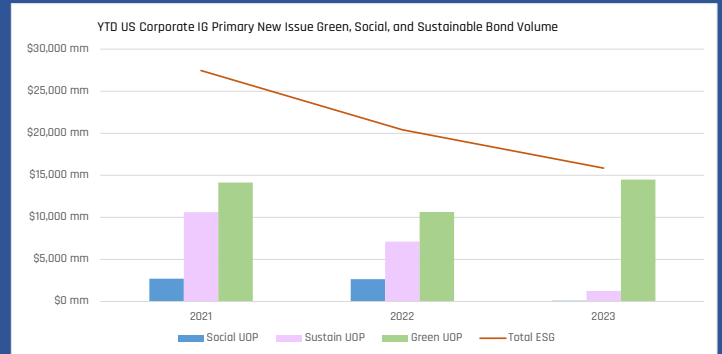
Information & Economy

Here in the U.S. and in Europe, certain governments are looking to use ESG related information (and their economic power) to establish themselves as the “go to” marketplaces for climate-focused industrial innovation and trade. In the U.S., the Senate recently introduced the bi-partisan Providing Reliable Objective Verifiable Emissions Intensity and Transparency Act (PROVE-IT Act 2023). Using the Harmonized Tariff Schedule, the act would create an average product intensity and includes three units of emissions measurement metrics across numerous products including cement, natural gas, Li-ion batteries, hydrogen, solar cells, refined petroleum products, critical minerals, and steel (among others). The goal is to not only provide more reliable data that quantifies U.S. investments, but to also hold other nations like China more accountable for their carbon-intensive products. Ultimately, this legislation could impact over 15-20% of all U.S. trade exports!

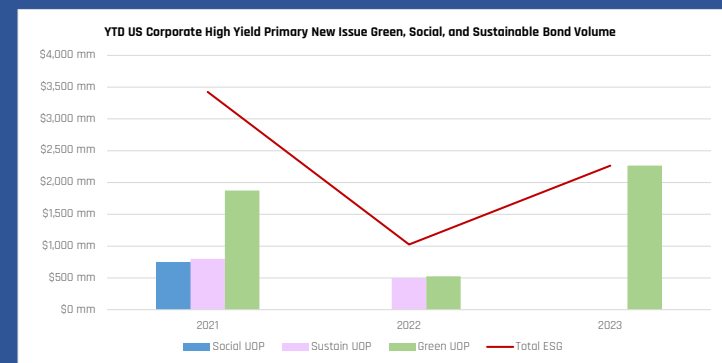
Europe already has a robust set of regulations (part of its Green Deal) including its Sustainable Financial Disclosure & Reporting laws (SFDR), EU taxonomy, the EU green bond standard, and its recently proposed regulation on ESG ratings/transparency. The Corporate Sustainable Reporting Directive (CSRD) is the latest addition and is an addendum to the Non-Financial Reporting Directive (NFRD). It amends several previous areas including sustainability reporting, consolidated sustainability reporting, guidance on small & medium sized businesses, electronic reporting, third-country undertakings, audit, and assurance. Ultimately, it will increase reporting requirements as well as the scope of reporting entities. It's expected that the changes for the third-country undertakings along with small & medium sized businesses could take the number of reporting entities from around 11,000 to about 50,000.

The potential for impact is not only substantial, but it also highlights the unique strategies that nations are employing that include using their economies and information to gain a foothold in the markets in which they compete to create geopolitical leverage. The U.S. has a more direct approach: gather information, create benchmarks, and showcase that

2023 U.S. Green, Social, and Sustainable Debt Volume



Investment Grade: While total GSS labeled debt is down YoY, 2023 YTD new issue U.S. IG corporate green bond volume has surpassed 2021 & 2022 YTD issuance. U.S. IG Companies this year have printed over \$14bn in green labeled debt, buoyed by Verizon, BofA, and PacifiCorp which came to market in May & June with green use of proceeds bonds.



High Yield: U.S. high yield corporate green bond volume has seen its busiest YTD performance since 2021. Owen-Brockway, ZF North America, and Brookfield are among this year's HY issuers. Source: Bloomberg.

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U.S. products (especially industrial tech) are “greener” so others should trade with the U.S. Europe on the other hand, has created complex laws/market mechanisms meant to attract or develop “green” capital & businesses primarily through transparency and disclosure. Both the U.S. and Europe have also invested heavily. As part of its Green Deal, the EU intends to invest 1 trillion euros. The U.S. (via the IRA, Bipartisan Infrastructure Law (BIL), and CHIPS Act) has introduced \$2 trillion in spending over the next 10 years, much of which is going to clean energy.

Diplomacy & Military

Uses of diplomatic and military power are also likely to increase as risks associated with climate related conflict manifest themselves and nations look to gain a competitive advantage. The Grand Ethiopian Renaissance Dam is one example where changing climate and infrastructure development are increasing intra-nation tension. In this example, it is forcing Egypt and Ethiopia to resolve the tension via diplomacy. Extended drought in places like the Sahel region, Somalia, Yemen, and other parts of the world have already instigated conflict resulting in displaced communities/refugee crises. These crises become especially important when nations like China, Iran, Russia, and North Korea can look to leverage the situations. Simultaneously, terrorist organizations and non-state threat actors take advantage of power vacuums and vulnerable populations to recruit and continue their operations.

Another area of diplomatic & military action is in deep sea mining. While nascent, the global energy transition has accelerated the need for rare earth minerals. Ocean floor mining has not been a viable economic option due to a combination of technology, cost, and regulatory issues. Norway's announcement that it is submitting plans to develop an extraction area located throughout the Greenland and Norwegian Sea could inspire accelerated interest in other parts of the world and drive diplomatic & military tensions. Two likely examples of this would be the Arctic and East China Sea.

The combination of minerals and increasing maritime access is pushing states that operate in the Arctic to protect their interests. These nations include Canada, the United States, Norway, China, and Russia. Russia has been building up its presence in the Arctic due to the melting ice which will create shipping lanes. In addition, Russia placed a flag on the North Pole seabed and is looking to extend its continental shelf. China has also been active with its Belt and Road Initiative and deepwater port cooperation with Russia. As a result, the U.S. Navy has its *Blue Arctic* plans where it intends to be more assertive in the region through enhanced presence and partnership.

Another area to keep an eye on is the East China Sea. The location is rich in sea floor “massive sulfides” which contain copper, zinc, silver, and gold. It is also the location of a longtime territorial dispute between China & Japan. As ocean floor mining heats up, it could place further stress on how surrounding nations leverage their militaries and diplomacy to maintain an advantage.

Bottom Line

- We should continue to expect “ESG” to be used as a political football, especially with the upcoming election. However, with the PROVE-IT Act we see bi-partisan alignment that will hopefully highlight our nation's sustainable performance (compared to that of our strategic competitors) when it comes to industrial innovation & technology.
- The EU's legislative package really underscores how governments on the continent are looking to create markets that establish themselves as hospitable environments for industrial climate innovation. It will also require many more companies to report.

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- Plenty of risks remain. The global energy transition (while possibly creating opportunities for businesses like ocean floor mining) could place stress on maritime diplomacy and underwater ecosystems. The increasing number of extreme weather events in parts of the upstream value chain (i.e., a major hurricane or drought near a supplier) could also suspend operations, increase reinsurance risk, or even result in conflict in volatile regions.

Further Resources

U.S. Senate PROVE-IT Act test: https://www.coons.senate.gov/imo/media/doc/prove_it_act_118th_congress_bill_text2.pdf

Dept of Commerce: [https://www.bis.doc.gov/index.php/documents/technology-evaluation/ote-data-portal/3017-2021-statistical-analysis-of-u-s-trade-with-the-world/file#:~:text=In%202021%2C%20of%20the%20%241.8,%25\)%2C%20the%20same%20as%202020.](https://www.bis.doc.gov/index.php/documents/technology-evaluation/ote-data-portal/3017-2021-statistical-analysis-of-u-s-trade-with-the-world/file#:~:text=In%202021%2C%20of%20the%20%241.8,%25)%2C%20the%20same%20as%202020.)

EU CSRD: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464>

FT, "Norway Seeks to Open Vast Ocean Area to Deep Sea Mining": <https://www.ft.com/content/44855d32-82c2-4f4c-b77c-1c21d3c1279f>

Navy, Blue Arctic: <https://nps.edu/web/eag/navy-releases-strategic-blueprint-for-the-arctic>

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