



China “EPA” Crackdown Shuts Down Tens of Thousands of Factories...with No End in Sight.

Miami Chemical Special Report

Chances are if you are partnered with [Miami Chemical](#), you have probably been largely shielded from the supply disruptions that are everyday occurrences in China right now. Miami Chemical's extreme vetting, due diligence and “boots on the ground” culture combined with partnering with and fostering long term relationships have been proven effective throughout years in minimizing supply chain disruptions and weathering supply storms. Effective sourcing is not about saving tenths of a penny, it's about being informed and proactive (not reactive) to market conditions that safe you from the peaks of the pricing curves.

It is our goal that our partners never buy at peaks!

China Today: A Hard Stance Against “Heavy Polluters”

Forget the China of old with the wild wild west environmental mentality. Since June of 2017, China's new Ministry of Environment is taking a hard stance against Chinese factories that are “heavy polluters”. In fact, the most recent round of factory audits, China's environmental crackdown has shut down tens of thousands of Chinese factories with no end in sight. That is not an exaggerated number. Tens of thousands!

The effects of decades of massive manufacturing growth has taken its toll on the environment. To put this in perspective, the USA underwent an Industrial revolution from 1760 to around 1840 (80 years). China has seen similar type of growth just in the past decade. The result is now China has some of the most polluted cities in the world. Air purifying equipment and anti-pollution masks are often sold out. Groundwater is polluted making safe drinking water a big concern. But now the government is now doing something about it. And in China when the government talks to people listen.

What's different this time than previous years is that a hard stance is being taken in making sure that factories are compliant with environmental laws. Previously when policies were passed there was little to no compliance. Many factories were unaware or unwilling to comply so they continued operating in their old polluting ways or were able to use "guanxi" to avoid adhering to the new standards



What is Guanxi? Guanxi = the system of social networks and influential relationships that facilitate business and other dealings.

With the new government stance, Guanxi no longer has ultimate say in who is running and who is shut down. Some factories have even forced to cease their production immediately and indefinitely until they are compliant. And if they don't comply, the government is even completely shutting off their power literally leaving them in the dark.

Government Power trumps Guanxi

Why suddenly is government power trumping "guanxi"? Decisions are coming directly from the top levels of government so it overrides any relationships factory owners may have at the municipal levels. If the factories are noncompliant they will face the consequences if they are audited.

Real Issue: Lack of Transparency with No End in Sight

One of the main issues the factories face is a lack of transparency. Government policy details are quite opaque and many factories are not even aware of the exact policies they must abide by, so they may unknowingly continue to operate in noncompliant ways and risk being shut down. A large segment of the chemical factories fall into this category. They are not directly being negligent. Most will and want to adhere to the regulations once they have a clear picture and definition of what they are. But spending money for something that might not even be an issue is not a cultural norm in China. Almost all factories want to avoid instances and conflicts with the government inspection teams. It causes major disruptions and most believe investing to stay compliant is worth the money rather than attempt to avoid it. Again, only once they understand what that means.

With unclear policies factories in China face an unpredictable and ongoing risk of being suddenly told to shut down. Combined with no clear timelines given by officials also mean factories don't know when or if they can resume production once they are shut down.



So Who's Affected?

The shut downs are much broader than the chemical industry itself. Affected industries also include Textiles, Rubber, Leather, Chemicals, Carbon, Metal, Coatings, Plastics, Dyes, Painting, Printing processes and even more. A good example of this is a widely used product called



Titanium Dioxide. TiO_2 , a pigment used across many applications including paints and coatings, has seen 72 feedstock plants permanently been closed in the past year.

How are the Shutdowns Occurring?

The environmental audits have been implemented in rollouts that have begun in certain regions mostly centralized in and around Northern China. These regions get very little notice before an audit occurs, maybe 7-10 days only. When suddenly a factory claims they are shut down for an audit. More often than not they are speaking the truth that they did not know beforehand. The later phases of the shutdowns will reach other regions. But the high smog and industrial areas appear to be targeted first. Again, it's difficult to pinpoint exact areas due to lack of transparency.

What Happens When a Region is Audited?

When a region is audited, the worst thing that could happen is someone on the inspection teams get injured. This could occur through an accident or even rare cases even disgruntled employees upset about the shutdown. So almost always all factories will stop production during these audits. This protects the government inspectors, but also helps the factories by hopefully reducing the number of issues they may find that need fixing. Most times, if an accident occurs during an environmental audit, the local government official is immediately relieved of his duty. Because of this, the local government official will often err on the side of caution and shut down large areas to prevent issues

What Regions are Currently Affected?

So far we know the following regions are currently being affected:

- Shandong, Henan, Hebei, Tianjin, Beijing, Zhejiang, Jilin, Jiangsu, Sichuan, and Guandong



Why is this happening now?

To understand why it is happening now you need to look back into the past.

In 2013, China passed the “10 Measures for Environmental Protection” which outlined measures to improve China’s environment. This was a monumental step as China began addressing and admitting to its environmental problems head-on while in the past China was more focused on developing its economy with manufacturing while paying a huge expense in air, water, and ground waste pollution. The newly appointed Minister of Environment demanded stricter compliance from the factories thus the extensive auditing and review of tens of thousands of factories occurred.

Winter in China is known as smog season. During the winter months smog is particularly bad. Because of this, China has begun restricting production levels of factories who are considered heavy polluters. So during November-February, many factories production levels are reduced significantly causing products that are in short supply to get even tighter.



View of Forbidden City during Smog Season



Same View of China during Summer/Non-Smog Season

Moreover, if we look at the macro level, China has an important government meeting in the 19th Plenum in Beijing, the most important government meeting which takes place every five years. Taking place on Oct 18th, 2017, the main objectives are to select the top leaders and policies to put in place as a road map for the country going forward. Factories around Beijing will most likely be shut down the month of October.

Environmental Protection is one of the key issues to be examined. It would make sense to do a bit of cleaning up before the meeting to drum up the numbers and produce some blue skies for them to take credit for.

Similar supply chain disruptions in China related to major economic, political, and social events have happened in 2016 in the months preceding the G-20 meetings in Hangzhou as well as in 2008 before the Beijing Olympics.

Other speculators say that another reason for potential mass shutdowns is because of a major sporting event and competition at the national level happening in north China (Beijing area) in the fall. This is most likely a less probable cause than the 19th Plenum which is the most important event that will set the stage for the future of China in the next five years.

Understanding the Chinese Culture

Another important thing to understand is that Chinese culture doesn't encourage the revealing of bad news. Often, bad news is swept under the carpet until it absolutely has to be revealed. Announcing they failed an audit, sending out a press release of a factory fire, updating customers' orders will be late. This is common practice in USA but is difficult for USA customers to understand in China, often this information is not given until it absolutely HAS to be shared. Our best advice is it pays to be proactive right now. Talk to us about what that means and have a plan in place based on what we information we are seeing (and sharing with you) in the marketplace.



How Miami Chemical is Protecting its Customers:

Our "boots on the ground" approach in China with a full time staff constantly evaluating the situation and keeping a finger on the pulse of the markets has made the difference in Miami Chemical Supply Chain strength. Our China President who is a chemical engineer has been involved in many of the environmental meetings during the past years and have worked with make sure Miami Chemical factory partners are the ones positioned for longest term growth and supply. We have walked from doing business with hundreds of factories to be best aligned for what we feel is strategic growth and supply chain management. It is impossible to avoid all of the effects of such a large movement, but regular in person auditing of each factory and ensuring we are partnering with responsible manufacturers with the highest chance of successful long-term operations has kept us supplied when others are looking for product. This strategy while not always being the most economical, has proven over time to be hugely successful.

Also, having a sales team that is involved in knowing the product, the landscape of the market, the culture of the factories and feedstocks, and spending the extra effort to be there in person and do the extra work is what differentiates Miami Chemical from any other sourcing distributor that exists. Our entire sales team and upper management travels to these places and learns these things.

It generally does not take long to realize that difference working with informed, educated and dedicated partners has compared with those who only know a product name and a price.

Dealing with a company who knows is strategic in its products, the players, the feedstocks, the factories and takes long term inventory positions on them to ensure when the market falls apart Miami Chemical will be there.

And we have.

