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Japan to lift cap on defence spending

Shift will enable Japan to better contribute to regional security

In an exclusive interview with *Nikkei Asia*, **Japanese** Defence Minister Nobuo Kishi revealed plans to increase Japan's defence capabilities at a "radically different pace" than in the past. Kishi's comments have been widely interpreted as a concrete sign that Japan is ready to dispense with its traditional one percent of GDP cap on defence spending. Though not constitutionally enshrined, the cap has been maintained to help realise Article 9 of Japan's "Pacificist" post-war Constitution. Article 9 de facto prohibits the Japan Self-Defence Forces (JSDF) from attaining offensive capabilities.

Several factors are pushing Japan to play a security role more commensurate with its size and economic strength. The outcomes of late April's in-person summit between **US** President **Joe Biden** and Japanese Prime Minister **Yoshihide Suga** made one thing clear. Washington wants and needs Tokyo to share more of the burden in countering **China**. In this regard, the Japanese Defence Ministry's draft annual White Paper is particularly illuminating. It is the first Japanese Defence White Paper to explicitly discuss the deteriorating military balance in the **Taiwan** Strait. Of course, with persistent Chinese incursions in the waters surrounding the Japanese-controlled Senkaku Islands, Japan also has concerns (slightly) closer to home. In recent months, Tokyo has been grappling with how to beef up the capabilities of the JSDF to respond to a Senkaku-related military contingency. Kishi's interview specifically flagged bolstering defences across the Nansei Island chain which adjoins both the Senkaku's and Taiwan. Increased Japanese defence spending will irk China and possibly raise eyebrows in **South Korea**. However, many in the region – particularly in Washington – will view it as past time that Japan stepped up to the plate.

Indonesia's sovereign wealth fund (SWF) draws first official commitment

Encouraging sign for fund that has hitherto shown more hype than substance

Late last week, a consortium of funds from **Canada**, the **UAE** and the **Netherlands** announced that they will co-invest US$3.75 billion in toll roads with Indonesia's sovereign wealth fund (INA). The funds in question are a subsidiary of the Abu Dhabi Investment Authority (which in March pledged to invest US$10 billion in INA), Canadian pension fund Caisse de Dépôt et Placement du Québec and its Dutch counterpart, APG Asset Management. Under the specific terms of the MoU, each fund will invest US$1 billion into a toll road investment vehicle, whilst INA will commit US$750 million. The vehicle is expected to make its first investment in six months, with further investments likely down the track. It is unclear what specific assets will be invested in, though INA previously signalled that it expects to acquire up to 11 of debt-ridden state-owned construction company Waskita Karya's toll roads.

The formation of the toll road investor consortium was no doubt a source of relief in Jakarta. Previously, potential investor interest has been loudly broadcast without any tangible results. There has also been no shortage of commentary citing INA's potential pitfalls. These include the potential for political interference, exposure to poorly managed SOEs and Indonesia's generally challenging business environment. On the topic of SOEs, however, it is worth noting that there SOE Minister Erik Thohir appears to have made some progress in this area. Jakarta has so far consolidated 142 similar SOEs into 107 and is the process of restructuring another 60. Plans are afoot for 14 SOEs to conduct IPOs which is highly significant insofar as privatisation is generally anathema in Indonesia. So, whilst challenges undoubtedly remain, international investors are paying serious attention, with the added potential for further positive changes.

Presidential executive order puts climate-related financial risk into focus
Impact of regulations will depend in part on their alignment with pre-existing global standards
Last week, **US** President **Joe Biden**'s White House released an executive order on climate-related financial risk disclosure. The new regulations will require a suite of different agencies – ranging from the Federal Reserve to the Retirement Thrift Assessment Board – to consider climate change risk in their oversight work. Some departments like Veterans Affairs will be required to consider climate risk in their procurement processes. A report on government climate-related financial risk is due in the next 120 days, with recommendations from the Treasury to follow 60 days later.

The overall purpose of this new regulatory thrust is to support Washington's overall goal of reducing emissions. Greater oversight of procurement processes will likely be designed to lower the US' exposure to emissions-intense supply chains. Ultimately, the global impact of whatever Treasury comes up with will be magnified if it aligns with pre-existing (especially European) standards. However, US climate tsar John Kerry has signalled that his country is unlikely to adopt the **EU'**s newly minted taxonomy. Biden may want to opt for more flexible definitions of what counts as 'green', as the Democrats are wary of alienating communities reliant on fossil fuel extraction, especially before the 2022 mid-terms. We may well end up with a different taxonomy on each side of the Atlantic. Dreams of a US-EU climate alliance acting in complete lockstep might be just that.

Washington prevails over Beijing in strategic telecoms deal in Ethiopia
It remains to be seen whether industry will be able to capitalise on the opportunities presented by the deal
Ethiopia's first telecommunications operating license has been awarded to a **US**-backed consortium led by Vodafone Group's Safaricom. The losing bidder was **South Africa**'s MTN Group, which was backed by **Chinese** investors. Vodafone will implement nationwide 4G coverage by 2023 and build a 5G network by 2030. Under the financing terms, Vodafone cannot purchase telecom equipment from China's Huawei. The deal is a win for Washington – which seeks to counter China's influence in the strategic Horn of Africa – and non-Chinese suppliers that will be favoured by the project.

President **Abiy Ahmed** maintains the much-vaunted deal will enable Ethiopia's firms in the manufacturing, agriculture and tourism sectors to capitalise on the opportunities presented by the application of 5G application. Ahmed has pledged that Ethiopia will be the leading manufacturing hub in Africa by 2025. Structural transformation of the economy must accelerate for industry to properly derive value from the 5G rollout. Despite posting growth of around 10 percent per year since 2010, Ethiopia remains reliant on low value-added production in the primary agriculture sector. Primary agriculture accounts for 32 percent of GDP and 84 percent of total exports. The technological complexity of current manufacturing is also low. Approximately 70 percent of the country's manufactured exports are low-tech. An unskilled workforce with limited digital skills is another barrier to an industry using technologies like robotics, AI and machine learning.

Competitive labour costs and recent investment in large-scale infrastructure projects is cause for optimism. However, these modest signs of improvement are unlikely to be enough to achieve all of Abiy's ambitious 5G application goals.

EU division is a threat to its global climate leadership role

Fossil-fuel dependent eastern economies remain offside

At an extraordinary Summit in Brussels earlier this week, the **EU** failed to agree on how to apportion the burden of reaching its target of reducing greenhouse gas emissions 55 percent by 2050 on 1990 levels. Logically, the target demands a broader Emissions Trading Scheme (ETS) and deeper targets from Eastern countries. Only around 40 percent of total EU greenhouse gas emissions are regulated by the ETS. The scheme includes energy-intensive manufacturing sectors, electricity and aviation. Under the burden-sharing agreement currently in place, **Bulgaria** could keep emissions unchanged from 2005 levels and **Poland** would be required to reduce emissions by just 7 percent. On the other hand, countries like **Germany** must reduce emissions by 38 percent and **Sweden** 40 percent.

At the Summit, Poland, alongside **Romania**, Bulgaria and the Baltic countries argued that the more ambitious target would have a disproportionate effect on less wealthy countries. Warsaw claimed broadening the scope of the ETS to include heating and transport would have a regressive impact on consumers.

The EU had been aiming to achieve agreement before July, when the European Commission's Green Deal is expected to be adopted. The post-Summit communique promised to revisit the issue after the Green Deal is released. Climate finance like the €17.5bn Just Transition Fund – established to address the social impacts of the transition – and the newly overhauled European Investment Bank will need to play a major role in encouraging eastern economies to make bolder targets. Without more ambitious goals, the EU may not meet the objectives of the Paris Agreement. Ultimately, the east-west divide over the pace of the energy transition threatens to displace the EU as the global leader of climate action. It is also another example of the growing gap between the stated climate targets of governments and legislated policy.