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Japan's semiconductor future

Japan prioritises investment in domestic semiconductor production to ensure resilience amidst global shortages

Japan intends to maintain domestic semiconductor capacity following recent shortages that have exposed the fragility of the global semiconductor supply chain. Japan's share of global semiconductor production has fallen from 50 percent in 1990 to 10 percent in 2021, losing its shares to semiconductor powerhouses **Taiwan** and **South Korea**. Japan currently imports more than 60 percent of its semiconductors, many of them from Taiwan and **China**. Without a major change, Japan is expected to grow more dependent on unpredictable overseas supply. Semiconductors are crucial to Japan's value-added export industries, particularly its auto-sector.

In response, Japan's Ministry of Economy, Trade and Industry (METI) has released a report establishing a national strategy to fund the semiconductor industry and maintain Japan's 10 percent market share by 2030. METI's paper also highlights the importance of facilitating domestic production of advanced logic semiconductors. This specific project would necessitate up to US$45 billion of investment – though Japan has yet to determine the specifics of government support.

As Taiwan's semiconductor-manufacturing company (TSMC) currently accounts for more than 90 percent of global output, Japan has set the course for cultivating a long-term relationship with TSMC as a key part of its overall strategy. TMSC signed a deal in July to begin operating its first chip plant in Japan by 2023, subject to corresponding Japanese investment and support. Though Japan has at times been perceived as disrespectful towards Taiwanese expertise, the deal clearly suits both parties. For TSMC, the move helps create a counterweight to resist strong pressure from Washington to shift its high-end technology to the **US**.

Yet, matching the financial power of the US or the **EU** will be a challenge for Japan. The US has committed to spending a minimum of US$52 billion and the EU will commit a portion of its US$159 billion digital economy package. Japan' increasing debt amidst the COVID-19 pandemic may also limit its progress in an industry that demands rapid investment.

Progress to Chile's National Mining Policy

Chile seeks to address inequality through sustainable mining

This week, **Chile**'s Ministry of Mining unveiled part of its much-anticipated National Mining Policy. The policy prioritises the decarbonisation of Chile's mining industry and social welfare. This heightened focus on social license is a consequence of demands for increased public spending following widespread protests in late 2019 fuelled by economic inequality. By 2050, Chile aims to achieve net zero mining production, use less than 10 percent of continental water in copper ore processing. Another aim is to increase women's participation in management positions to 35 percent by 2040. Digital platforms will play a key role in tracking the industry's energy consumption and verifying carbon emissions.

The final part of the policy is a bill for a law to increase mining royalties. If approved, the bill will increase mining royalties by at least 75 percent if copper prices are maintained at or above US$8/kg. Copper prices are around US$9/kg and are expected to stay high amidst supply shortages and heightened global demand owing to copper's various uses in electrification. The proceeds from the increased royalties will be used to fund regional development projects. The bill has passed through Chile's lower house and the Mining and Energy Commission but is yet to pass the Senate. President **Piñera's** administration is expected to seek to reduce the hike in royalties – however an increase of some form is still likely to proceed.

The increased state share of royalties is expected to squeeze the profits of mining companies operating in Chile, which have capitalised on attractive foreign investment conditions. Whether the new laws strike the right balance between reducing inequality and maintaining foreign investment remains to be seen.

ASEAN sets 2025 renewables target

ASEAN renewables goal warrants a collective effort

The Association of Southeast Asian Nations (ASEAN) has set a target to generate 23 percent of its total energy supply from renewables by 2025. Simultaneously, ASEAN faces a 50 percent rise in regional energy demands within the decade. This necessitates an approach that maintains energy affordability and guarantees energy security as the proportion of fossil fuels in the energy mix declines.

ASEAN's target represents a sharp increase in what is a tight frame. In 2018, the bloc generated just 13.9 percent of its energy supply from renewables. According to the ASEAN Centre for Energy, ASEAN's current policies puts it on track to reach only 18 percent renewables by 2025, leaving a seven percent gap to fill. To achieve the target, ASEAN is projected to need at least US$27 billion of investments annually.

Increased renewable uptake – though expensive – presents clear economic opportunities. Increased investment in solar photovoltaic (PV) cells, for example, will allow local manufacturing industries to grow to meet increased needs. **Malaysia**, for example, is the world's third largest producer of PV cells and potentially stands to gain.

ASEAN is searching for a strategy that takes into account country-specific energy contexts, given the diverging policies of developing and developed Southeast Asian countries. ASEAN policies are typically non-binding, presenting difficulties in incentivising states to meet the target.

Garuda Indonesia faces debt restructuring

Indonesia's flagship state airline on the brink of bankruptcy

Indonesia's state-owned airline Garuda is under increasing financial pressure after years of weak earnings, exacerbated by COVID-19. Pandemic-related travel restrictions have caused revenue to drop by 67 percent to US$1.5 billion. Garuda recently defaulted on a US$500 million Sharia-compliant Islamic bond, known as *sukuk,* struggling under US$4.9 billion worth of debt.

Analysts predict that Garuda needs between US$1.3 billion to US$3 billion in fresh capital to remain operational. However, Indonesia's Government has been reluctant to bail out Garuda, facing pressure from other SOEs struggling to pay their pandemic related debts. Jakarta's SOE debt remains high, with cumulative external debt reaching US$59.65 billion as of March. To avoid setting a precedent, instead of bailing out Garuda Jakarta has instead decided to push the airline to enter debt-restructuring negotiations with aircraft creditors.

Expect Garuda's corporate leadership and Jakarta to use the threat of bankruptcy to extract more lenient conditions from the airline's creditors. The same tactic was used by the **Malaysia** Aviation Group to save Malaysia Airlines. After threatening to declare bankruptcy, a British court approved an agreement to restructure nearly US$4 billion owed to airplane lessors.

Indonesia is far from alone. Several other governments have been forced to bail out or support major national airlines during the pandemic, including **South Africa's** South African Airways. Although Indonesia's economic recovery is predicted to suffer a major setback next quarter as the COVID-19 situation worsens, Garuda's flagship status and role as a major employer will likely motivate Indonesia's Government to intervene to ensure the airline stays afloat.

China places import restrictions on Lithuania

China's use of import restrictions – rather than its typical approach of targeting exports – marks a change of tact in its economic coercion playbook at a critical juncture in EU-China relations

Train operator **China** Railway Container Transport Co has suspended direct freight trains to **Lithuania**, amidst a diplomatic feud over **Taiwan**. Beijing claims that Lithuania's decision to allow Taiwan to open a "Taiwanese Representative Office" in Vilnius is in breach of the One-China policy. In response, Beijing has suspended the transit of cargoes and recalled its ambassador to Lithuania. To avoid diplomatic spats with Beijing most states typically refer to Taiwan as Taipei when naming their representative offices.

Despite pressure, Vilnius shows no signs of reversing its policy towards Taiwan. Lithuania is markedly less exposed to China's weaponisation of trade compared to countries like **Germany** and **Australia**. Trade volumes between Lithuania and China are relatively low. China is Lithuania's 12th largest import partner and its 23rd largest export partner. Investment flows are low too, with less than US$100 million in Chinese investment made in Lithuania between 2000 and 2020. Lithuania attracted US$265 million in FDI this June.

Vilnius' decision is not an isolated incident. In February, Vilnius withdrew from the "17+1" summit, a China-led platform to engage central European countries and advance the Belt and Road Initiative (BRI). Multiple smaller European countries, such as the other Baltic states and **Romania**, have also taken a tough stance with China, urging the EU to follow suit and adopt a more hawkish posture. These countries' grievances with China are varied but include its closer ties with **Russia**, the slow pace of the 17+1 Initiative (only around 4/40 promised projects have been completed), various instances of political interference and espionage and genuine concerns over human rights abuses. Taiwan's perceived resistance to Chinese authoritarianism also has a particularly historical resonance in parts of Eastern Europe.

With Chancellor of Germany Angela **Merkel** – a staunch advocate of engagement with China – about to leave office, the EU's China policy sits at a critical juncture. Whilst some states in the EU are leaning towards a tougher approach on China, as always, achieving an EU wide approach will prove difficult.