

I nternational Order on Economic Security

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Introduction

In order to discuss economic security, it is necessary to clarify the “threat” that is the premise of the discussion. When the government talks about economic security, it states that it “does not have a specific country in mind” but this is only due to diplomatic considerations; in light of the National Security Strategy compiled in December 2022, China is clearly the focus of today’s threats facing Japan’s economy.

First, I will identify specific threat movements in China that are a prerequisite for Japan’s economic security and discuss Japan’s preparedness for them. Second, regarding semiconductors, the main battlefield of the US-China confrontation which has become the focus of economic security, I will clarify the intensifying tug-of-war between the United States and China and Japan’s position in it. Third, I will look at how the international order is undergoing a major transformation centered on economic security, from the perspective of the unity of Japan, the US, and Europe (G7) and the inclusion of emerging and developing countries (Global South).

“Threats” to Be Addressed for Economic Security

There are three key phrases in President Xi Jinping’s administration in China that are indispensable when discussing economic security. They are “military-civilian fusion”, “dual cycle”, and “self-improvement”.

The “military-civilian fusion” is an attempt to promote the upgrading and strengthening of military power and industrial power in an integrated manner. The “dual cycle” refers to both domestic and international cycles. In the domestic cycle, strategic industries such as semiconductors are to be domestically produced from upstream to downstream in the supply chain (supply network) and circulated domestically. In other words, the goal is to achieve self-sufficiency within China. This means an economic system that does not depend on the US and other Western nations, and is inextricably linked to “self-reliance and self-sufficiency”.

International cycles seem desirable because they strengthen economic interdependence, but they are not: in a speech in April 2020 to a domestic audience, Xi said, “Enhance our ability to counterattack and strike by making the rest of the world more dependent on China.” I will address this later as “weaponization of the economy” and “economic coercion”, and focus here on the

domestication strategy.

Domestic production by China is now increasingly accelerating (*Chart 1*). In 2015, China announced its “China Manufacturing 2025” policy and set a goal of increasing self-sufficiency in semiconductors and other strategic industries. For example, as seen in the “Plan to Strengthen the Electronic Components Industry” issued in 2021, plans are being elaborated for each industry. Furthermore, in view of the economic sanctions imposed on Russia by Western countries after its invasion of Ukraine, China has become even more eager to domesticate strategic industries, with a Taiwan contingency in mind.

The report lists specific technologies that are bottlenecks to the domestication of strategic industries. Then, after listing the Japanese and other foreign companies that possess these technologies, China attempts to attract these foreign companies by providing them with access to the Chinese market. When it does so, it demands that the foreign firms enter the Chinese market as a joint venture with Chinese firms. Once the foreign firms have been lured and Chinese firms have access to the technology, they will boldly invest with the support of massive subsidies to gain an advantage in cost competitiveness. Then China shifts from “attraction mode” to “exclusion mode” with respect to foreign firms. This pattern has been repeated time and time again in various industries.

For example, a Japanese company that once had an overwhelming technological advantage in high-performance magnets used in electric vehicle (EV) motors was lured and entered a joint venture

CHART 1

Domestic production in strategic industries ⇒ use against foreign companies

(weak) ⇒⇒⇒ Competitiveness of Chinese Companies ⇒⇒⇒ (Competitive)

“attraction mode” (bottleneck technology)	“exclusion mode”
<ul style="list-style-type: none"> • Semiconductors (equipment, materials) • Electronic components (smartphones, 5G core components) • LCD panel materials, OLED materials • Machine tools, robots • High-performance medical devices 	<ul style="list-style-type: none"> • lithium-ion batteries • High-performance magnets • Solar panels • Wind power generators (turbines) • Automotive (EV), parts

Source: Compiled by the author

factory in 2016. After a few years, the technology was transferred to a Chinese partner company. Since then, this Chinese company has been growing rapidly.

Japan is not alone in having such bitter experiences. The same is true for medical devices and wind power generation in Europe and the US. Europe is finally realizing these Chinese strategies, and the European Union (EU) Chamber of Commerce and Industry in Beijing has issued a report sounding the alarm.

Currently, China is actively trying to attract Japanese companies with a focus on semiconductor equipment and materials, and advanced electronic components such as laminated ceramic capacitors with a technological edge. These Japanese companies need to be very careful.

In this strategy of enhancing domestic production, in addition to attracting companies, acquisitions are also a means of acquiring technology. In many cases, the target is not necessarily a large company, but a small to medium-sized company that is a supplier of core components to a large company. Thus, China is trying to acquire bottleneck technologies through two means: attraction and acquisition.

Moving to Deal with the Situation

This threat of from China's domestication strategy is also serious for South Korea and Taiwan. They are dealing with it with heightened vigilance. In August 2022, South Korea enacted the National Advanced Strategic Industry Act, which requires export approval for 17 advanced technologies in four fields: semiconductors, displays, batteries, and biotechnology. Taiwan also amended its National Security Act to prevent the outflow of advanced technologies and designated 22 items in five fields, including advanced semiconductors, as the first phase of "national core technologies" in December 2023.

Japan is not well prepared for this. Recognizing the need for Japan to act, the government is moving to strengthen its economic security measures. Of particular concern are semiconductor manufacturing equipment and materials and electronic components, where Japanese firms have an advantage. The problem is that "essential technologies" in these strategic industries are not regulated by the Foreign Exchange and Foreign Trade Law, and concerns about outflows cannot be ignored. The reality is that Japan is unable to respond to China's current moves to acquire technology in strategic industries.

Although companies should be able to make their own judgments on how to draw the line between security sensitive technology and others, they tend to be lax because of this lack of regulations. Therefore, Japan needs to consider the establishment of a legal system as well.

There is also a problem with the regulations under the law with regard to acquisitions. There is a system in place that exempts

private Chinese firms from prior notification of acquisitions of private Japanese firms. Japan should face the reality that China is tightening its control over private companies, even those that are not state-funded or state-owned enterprises, and close these "loopholes".

Tug-of-War over Main Battlefield & Semiconductors

The greatest focus of economic security is semiconductors, which are China's Achilles heel. The fierce battle over semiconductors between the US and China is becoming increasingly intense. China has been promoting domestic production of semiconductors since around 2015 by creating a 10 trillion yen fund with the aim of increasing its self-sufficiency. In addition to attracting semiconductor manufacturers such as South Korea's Samsung Electronics and Taiwan's TSMC, it is also providing huge subsidies to Chinese manufacturers to foster them, and huge investments are being made.

The US administration of President Joe Biden passed the CHIPS Act in August 2022 that allocated approximately \$52.7 billion for domestic semiconductor manufacturing. This was a move to protect the semiconductor industry domestically in anticipation of long-term competition with China. Japanese equipment and component makers are also seeing a surge in transactions, pulled by the trend of increased investment in semiconductor manufacturing in both the US and China. This will be discussed later in this article.

Furthermore, in response to China's strategy of increasing domestic production, the US issued regulations on semiconductors to China in October 2022, which were further strengthened the following year. Japan also tightened export controls on manufacturing equipment for advanced semiconductors in July 2023. The Netherlands did the same, effective September 2023. The Biden administration is seeking dialogue with China, but the US Congress, which has a hardline stance on China, continues to pressure the administration for stricter semiconductor regulations. Biden has no domestic political latitude to loosen the restrictions on semiconductors from China, even if he can tighten them.

Against these US measures, China responded with countermeasures. In May 2023, China banned procurement of semiconductors from US semiconductor giant Micron Technology, and in August of the same year it made gallium and germanium, which are also semiconductor materials, subject to export approval. These moves are aimed at checking the US and other countries, but we should be wary of them based on an understanding of the facts.

First, China's measures will subject gallium and germanium to export controls, which China says are "to protect national security and interests". This is an excuse to avoid being considered in violation of the World Trade Organization (WTO). However, gallium is used in a wide range of electronic devices, including light-emitting diodes (LEDs), and it is unreasonable to restrict exports as an exception to WTO rules on the grounds of security.

A further problem is the opaqueness of the operation. By making the criteria for approval unclear, it makes it impossible for other parties to foresee the situation. The purpose of this is to have a check-and-balance effect; China is effectively saying, “We will turn off the tap at any time depending on future moves by Japan, the US, and Europe toward restrictions on China. If any problems arise, the WTO complaint should be filed by China.”

Caution over Legacy (non-advanced) Semiconductors

The US restrictions on China’s semiconductor industry have dealt a major blow to the factory operations of Chinese memory semiconductor giant Yangtze Memory Technologies Corp. (YMTC) and semiconductor foundry Semiconductor Manufacturing International Corp. (SMIC). Most observers believe that China will lag far behind in the production of advanced semiconductors, at least for the time being.

However, while all eyes are focused on cutting-edge semiconductors, they are not the only ones to be wary of. There are legacy (non-advanced) semiconductors such as power semiconductors. Logic semiconductors with circuit line widths of 20 nm to 40 nm, which are legacy (non-advanced) semiconductors, are used in large quantities in the automotive and consumer electronics industries. China is accelerating large-scale investment in legacy (non-advanced) semiconductors despite restrictions on advanced semiconductors. The country as a whole is making large-scale investments through subsidies to expand production capacity, bring it into overproduction, and sell the semiconductors overseas at low prices. As a result, the semiconductor industry in other countries may be devastated. The strategy is thus to make them dependent on China. This is a pattern that China has repeated in a variety of industries, including steel, solar panels, and electric vehicles.

It should be noted that Japanese materials and equipment technology is being targeted as part of the aforementioned strategy of domestic production. This is in order to complete the supply chain, including the upstream of semiconductors, domestically. Today, this trend is accelerating, and Japanese companies are being shaken up. Japanese companies with technology are being strongly urged by major Chinese semiconductor manufacturers such as YMTC and SMIC, who are their major customers, to enter factories as joint ventures. The goal, of course, is to acquire technology. Just as there is a serious outflow of engineers from South Korea and Taiwan, there is also a growing exodus of Japanese engineers.

Exporting to China is not the same as entering the Chinese market, and there is a huge difference in the risk of technological outflow. Even if a company does decide to enter the Chinese market, it should carefully assess what level of technology it should maintain. The government is also reviewing the nature of regulations, rather than leaving it up to the companies.

Toward an International Order Based on Economic Security

The international order is undergoing a major transformation based on “economic security” against the backdrop of the US-China confrontation. The economic sanctions against Russia by the Western powers in 2022 brought to light the essence of the current international order. The first is the unity of the Western nations, and the second is their divergence from emerging and developing nations.

1. Can Japan, the US and Europe “Unite” Against China?

Economic security is also an important pillar of the Leaders’ Declaration at the 2023 G7 Summit. It was agreed that the basic policy toward China is not “decoupling” but rather “de-risking”. This is meant to clearly counteract China’s deliberate external propaganda that the US is trying to decouple.

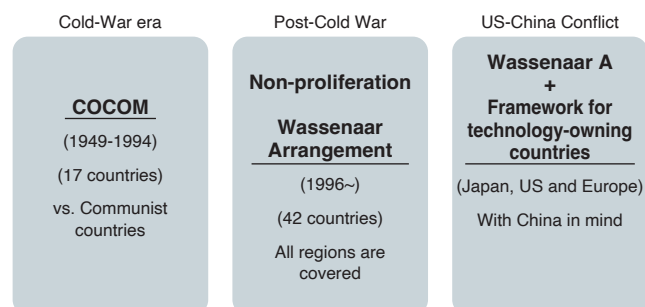
Economic security is a major topic of discussion at the G7, with a focus on advanced technology, including export controls, investment screening, and cooperation in semiconductors and emerging technologies. The “unity” in the Japan-US-Europe triangle is not limited to the G7. An economic version of the 2-plus-2 between the US and Japan, the Trade and Technology Council (TTC) between the US and the EU, and the High-Level Consultations between Japan and Europe, each of which is facilitated by ministerial-level consultations, are in place.

In this context, let us take up two specific themes where international cooperation is indispensable.

(i) Major Reforms in Export Controls

The international export control framework reflects the international order of the time (*Chart 2*). In the past, during the Cold War period of US-Soviet conflict, there was the COCOM

CHART 2
Transition of international export control regimes



Note 1: International framework related to conventional weapons

Note 2: A stands for arrangement.

Source: Compiled by the author

(Coordinating Committee for Multilateral Strategic Export Controls) by Western countries. The purpose of this was to ensure a “technology gap” with the Communist bloc, which would also lead to military power. With the end of the Cold War, the COCOM was abolished, and in 1996 the Wassenaar Arrangement (WA) was established as a post-Cold War international framework to replace it. This was a reform of export controls aimed at non-proliferation of arms to countries of concern.

Such non-proliferation export controls have required companies to distinguish between military and civilian end uses for general-purpose controlled items. However, China’s current policy of “military-civilian fusion” has made this distinction meaningless. Rather, export controls that prevent the outflow of technology above a certain level, such as advanced semiconductors, are needed, with the goal of ensuring a “technology gap” in high-technology that leads to improved military capabilities. This is analogous to the “technology gap” in the former COCOM.

However, unlike the Communist bloc during the Cold War, economic globalization has led to widespread economic interdependence with China. In addition, China is rapidly improving its technology in many key industries. Therefore, the areas of technological disparity are naturally limited. The US and Europe focus on advanced semiconductors, quantum, artificial intelligence, and biotechnology.

The US is aiming for a “high fence in a small yard”, so to speak, in which a small number of technology-holding countries, such as Japan, the US and European nations strictly control exports in these limited fields. A pioneering example of this is the export control of advanced semiconductor manufacturing equipment, which was recently introduced in a coordinated effort by Japan, the US, and the Netherlands. In line with the US, the export of equipment above a certain technological level is in principle not permitted, regardless of its intended use, on the grounds that it will lead to the enhancement of military capabilities.

In addition to export controls for semiconductors and other products, Japan, the US, and Europe will probably be oriented toward a new framework on how to strengthen export controls for emerging technologies such as quantum and biotechnology in the future. We have come to a new phase of export control in the few countries that have the technology.

(ii) Reliable Economic Zones by Sector

In recent years, China has been using its huge market and supply capacity to intimidate other countries and coerce them to change their policies, a form of “weaponization of the economy”. In 2020, in response to Australia’s request for an independent investigation to determine the cause of the new Corona virus, China imposed additional tariffs on imports of Australian barley and wine. In 2023, China imposed an embargo on seafood products from Japan in response to the release of treated water from TEPCO’s Fukushima

Daiichi nuclear power plant into the ocean. This was not based on scientific evidence, and should be seen as another example of economic coercion with a political agenda. The foreign policy of the Xi administration suggests that such economic coercion will continue in the future.

Fundamentally, in response to this, it is necessary to urgently build a supply chain that is not dependent on China. Focusing on the risk of supply disruptions by China, it will be extremely important to create an economic zone with “reliability” as a requirement without such risks. For example, cooperative agreements have been concluded with the US and other like-minded countries on supply networks for critical minerals, storage batteries, and other items. In the area of semiconductors, a framework for cooperation among the four “CHIP4” countries (Japan, the US, South Korea, Taiwan), plus Europe, is also conceivable. In this way, the “block stacking” method should be pursued, in which cooperation in each strategic industry is built up by field.

However, that is not enough. The G7 is also trying to take “joint action” against such economic coercion by China. There are two concrete actions. The first is to support the targeted countries and the second is to take countermeasures against economic pressure on their own countries. The G7 has decided to establish a “coordination platform” to work together. The question is what specific actions will be included in this platform. Japan’s response is being questioned in this regard.

As for countermeasures, Japan is the only G7 country that does not have the means. It is even reluctant to develop institutions that have the means to do so. Without the means to effectively respond to such coercion, Japan will be seen as an easy rival to deal with, and economic coercion may be repeated in the future. A mechanism to deter such coercion is necessary. Japan needs to have such a tool to collectively deal with the situation.

2. “Inclusion” of the Global South

The “inclusion” of the Global South, the emerging and developing countries, is even more important. In the midst of the confrontation between the Western powers and China and Russia over sanctions against Russia, the divergence between emerging and developing countries has become clear, so strengthening cooperative relations is indispensable.

In addition, there are many resource-rich countries in the Global South, and “resource nationalism” is on the rise as they seek to enclose resources within their own borders. Such countries include Chile, which is rich in lithium, and Indonesia, which has nickel resources, making the inclusion of the Global South important in terms of securing strategic resources.

In particular, the key will be how to retain India, the self-appointed leader of the Global South, and the fast-growing countries of the Association of South East Asian Nations (ASEAN). The Quadrilateral Security Dialogue (Quad) and the Indo-Pacific Economic Framework

for Prosperity (IPEF) can be positioned as tools for this purpose.

The Quad is important as a mechanism to bring India into the picture in terms of checks and balances against China, but Japan's contribution is significant because of India's strong trust in Japan. India is cautious about cooperation in the security field, and the glue that holds it together must be economic security. Japan has prepared a menu of economic security issues, including a next-generation telecommunications network (5G) and a semiconductor supply chain, which India is interested in, and Japan's input is essential for the continuation of such cooperation.

The IPEF was initiated by the Biden administration as an alternative to the Trans-Pacific Partnership Agreement (TPP). However, since the US will not open its markets, it is necessary to have a real alternative to the TPP in order to gain centripetal force. Therefore, the US government has been promoting its pragmatic advantage by taking the lead in negotiations in the area of economic security, such as the "strengthening of supply chains".

In the area of strengthening supply networks, the parties agreed to create an information-sharing network to assist countries facing supply disruptions in critical minerals, semiconductors, and other areas. Japan took the lead in developing a concrete concept for this. The IPEF mechanism builds on a project that Japan had already launched with other Asian countries. There is an economic reality in which Japanese companies are expanding overseas, especially in Asia. It can be said that Japan has taken advantage of this strength.

3. Serious Concerns about the Future of the US

But even these frameworks have a difficult road ahead. The Biden administration has been unable to start making rules for digital trade due to opposition from labor unions in the country, and negotiations in the trade area have been adrift or at a standstill. In addition, if Donald Trump wins back power in the upcoming US presidential election, it can be assumed that the US will withdraw from the IPEF.

There is some concern among G7 nations over the future of the US in the run-up to the presidential election. The Biden administration has so far demonstrated its stance against China by putting forward cooperation with allies and comrades, such as strengthening supply chains with friendly countries (friend-shoring). At the same time, however, there have been moves toward protectionism for reasons of economic security, such as the Inflation-Reduction Act (IRA), which have caused friction with allies and comrades, including the EU.

Furthermore, if a Trump administration were to reappear, we can expect a blatant shift to a policy of putting the US first rather than cooperating with the EU and Japan. Moreover, the administration's campaign promises show that it is still oriented toward a rough-and-tumble power game of tariffs. In contrast to this old-fashioned "tariff-based economic zone", Japan should develop a strategy to create an "economic zone of reliability" as mentioned above. The key to this strategy is to "make friends", including in Europe, where

China is attempting to encourage a break with the US.

Japan bears a heavy responsibility in the creation of a multilayered international order centered on economic security, as the future of both G7 unity and the inclusion of emerging Asian countries is in doubt.

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