Delhi Policy Group

Advancing India's Rise as a Leading Power

ECONOMIC SECURITY AND RESILIENCE REVIEW

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Author

V.S. Seshadri

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Core 5A, 1st Floor, India Habitat Centre, Lodhi Road, New Delhi- 110003

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Author

Dr. V.S. Seshadri, I.F.S (Retd.), Senior Fellow for Economic Security, Delhi Policy Group

Cover Image:

The United States President Joe Biden meets President Yoon Suk Yeol of the Republic of Korea in Washington D.C. on April 27, 2023. Source: The White House/Official Twitter

US Treasury Secretary Janet Yellen delivers a speech on the "U.S. - China Economic Relationship" at Johns Hopkins School of Advanced International Studies on April 20, 2023. Source: John Hopkins SAIS/ Official Twitter

US National Security Adviser Jake Sullivan delivers remarks on "Renewing American Economic Leadership" at the Brookings Institution on April 27, 2023. Source: The Brookings Institution/Official Twitter

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Abstract

In this issue of review, we begin by looking at the key findings on the impact of the growing geoeconomic fragmentation on world FDI, which forms a key focus of the IMF's World Economic Outlook for 2023. This is followed by a look at the discussions held by the G-7 finance ministers on the sidelines of the spring World Bank/IMF meetings, when they also took up the issue of economic resilience, and the strengthening of public finance tools that can help realise this objective.

At the bilateral level, we turn attention to the summit meeting held on April 26, 2023 between US President Biden and President Yoon of the Republic of Korea that marked another step in strengthening US strategic partnership with allies on economic security. We also briefly touch upon the bilateral export control meetings held between India and the US, and an agreement on critical minerals signed between the US and Japan which is indicative of what may form the substance of such agreements in the future.

The month also witnessed several China-related developments. There were two policy defining speeches, one by the US Treasury Secretary Janet Yellen and another by US National Security Adviser Jake Sullivan within a week from each other, which set out the directions of the Biden Administration's industrial and innovation strategy, and approach to the relationship with China, both of which were also significantly interlinked. We note in particular the three principal objectives set out by Yellen on economic relations with China. We also flag the key elements of Sullivan's address on renewing American economic leadership that brought out the compulsions behind this new strategy on the broader intersection between US domestic economic and industrial policies on the one side and national security, foreign and trade policies on the other. Recent actions taken by the Chinese authorities on US companies having operations in China are then briefly tracked. Of interest, indicating a contrary trend, is also how a few Chinese renewable energy companies are building plants in the US, attracted by the incentives on offer under the Inflation Reduction Act. A huge US$ 10 bn investment offer by a Chinese company on lithium mining in Afghanistan is another noteworthy development.

Among other items covered, the progress being made on the IPEF negotiations is noted. Also of note are the steps being taken by the US towards establishing a National Semiconductor Research Centre that is provided for in the US CHIPS and Science Act.

World Economic Outlook 2023 focusses on geoeconomic fragmentation and FDI

The IMF's annual world economic outlook has in this year's issue devoted a full chapter[1] on the impact of rising geopolitical tensions on world FDI patterns. The report looks at FDI figures for the last several years and other related company level data and points out, in the context of increasing geopolitical risks, that companies are showing interest in reshoring (back to home country) or friend shoring (shifting to a country seen as friendly to home country). The main conclusions outlined in the Chapter are:

- With resurgence of trade tensions between the US and China, FDI flows are increasingly concentrated among countries that are geopolitically aligned, particularly in strategic sectors like semiconductors. For instance, FDI flows to Europe and the US have proved more resilient than the flows to Asian countries in recent years (Quarter 2 of 2020 to Quarter 4 of 2022) compared to the preceding period (Q1 of 2015 to Q1 of 2020). FDI to China has declined by more than the Asian average. If geopolitical tensions were to increase and if countries were to move further apart on geopolitical faultlines, FDI is likely to become more concentrated within blocs of aligned countries.
- Emerging markets (EMs) and developing economies (DEs), which include India, are more vulnerable to such FDI relocation than advanced countries, since they rely on FDI mostly from countries with which they are relatively unaligned geopolitically. However better regulatory quality, that can lower this vulnerability, could help mitigate their exposure to FDI relocation.
- Vertical FDI, which takes place when foreign firms enter a country to produce inputs that will be supplied to affiliated firms, is more vulnerable to pressures towards friend shoring. But vertical FDI in strategic sectors is also knowledge intensive in nature. Entry of MNCs directly benefits domestic firms, particularly from technology transfers and increased local demand for inputs from foreign firms in domestic sectors.
- A further contraction in FDI and a shift in its geographic distribution would llikely have large negative effects on host countries through lower capital accumulation and technological deepening.

[1] See Chapter 4 of World Economic Outlook 2023, IMF.

- The report also does some simulations in the context of decoupling between the US and China and studies certain hypothetical scenarios based on how countries/regions could align themselves or remain unaligned. The model divides the world into eight regions/groups for this purpose, one of which is India plus Indonesia. While investment fragmentation could lower global output by up to 2%, its impact is expected to be more on the South East Asia-China bloc, on China itself and on the rest of the world. India and Indonesia may be somewhat less impacted in terms of long term GDP losses, but only relatively.
- Unaligned regions (like India) could have some negotiating power vis-a-vis geopolitical blocs, since the latter may have some incentives to attract the unaligned regions and discourage the unaligned from joining the opposing bloc. However uncertainty regarding their alignment could itself also restrict their ability to attract investment.

G-7 Finance Ministers meeting underline economic resilience

On the sidelines of the spring meetings of the World Bank and the IMF, the finance ministers and central bank governors of the G-7 countries met in Washington D.C. on April 12, when they also focussed on economic resilience. They pointed out in their statement that the flow of cross-border economic activities, including global supply chains, is increasingly viewed through the lens of achieving **both** (emphasis of author) economic efficiency and resilience. They further considered that their efforts to enhance economic resilience should also help accelerate social and economic transformation and help achieve deep emission cuts to reach net zero greenhouse gas emissions by 2050. In this they believed, for example, that diversifying the highly concentrated supply chains of important products for clean energy can contribute to safeguarding economic security, while creating new opportunities for value creation in the economy. The meeting also undertook to strengthen collaboration among the G-7 members and partners through the use of their respective public finance tools, which were spelt out in an annex focussed on building resilient supply chains in an era of decarbonisation, and was appended to the ministers' statement. The annex referred to public finance tools such as tax incentives, subsidies, guarantees and public loans and investment, and inter alia committed to empowering low and middle income countries to play a bigger role in supply chains through mutually beneficial cooperation by combining finance, knowledge and partnership.

Biden-Yoon summit marks another step in US efforts to strengthen strategic partnership with allies on economic security

The summit meeting between US President Biden and President Yoon of the Republic of Korea on April 26, 2023 in Washington D.C., commemorating 70 years of the alliance between the two countries, covered several areas, prominent among them a focus on economic security and resilience in supply chains. The joint statement itself noted that "from developing supply chains and investing in critical minerals and strategic sectors to combating the climate crisis and accelerating the energy transition - our two nations are deepening and broadening all aspects of our relationship at breakneck speed". President Biden, in his remarks to the press, notably acknowledged that since he took office, Korean companies have invested more than US$ 100 bn in the US.

Key outcomes of the summit on economic security included the following:

- A decision to establish a dialogue for next generation emerging and core technology led by their national security advisers on semiconductor chips, batteries, biotechnology, quantum science and other cutting edge technologies with a view to promoting joint R&D and experts' exchange;
- Commitment to building regional partnerships and coordinating measures to detect and address potential supply chain disruptions and strengthen resiliency. The two countries also shared deep concern about and expressed oposition to harmful uses of economic influence, including economic coercion as well as use of opaque tools with respect to foreign firms, and agreed to cooperate with like minded partners to counter economic coercion;
- Reaaffirmation of the the importance of deepening cooperation between their respective foreign investment screening and export control authorities;
- A commitment to cooperate in the development and deployment of carbon reduction, renewable and hydrogen technologies and enhancing energy efficiency in industry, construction and transportaion;
- A commitment to work together to develop open, transparent and secure 5G and 6G network devices and architectures using Open RAN approaches, both at home and abroad; and
- President Biden welcomed President Yoon's bold steps towards improving ROK-Japan relations and extended strong support for it, as also the joint statement noting that this opened the door for deeper trilateral cooperation on regional and economic security.

Prior to the summit, there had been speculation that the South Korean side could use the opportunity to secure more flexibility for Korean semiconductor and other companies investing in the US from the rather stringent conditions on their continued investment and business activities in China resulting from the US CHIPS and Science Act and the IRA Act. Similarly there were also reports which suggested that the US could use the summit for securing an understanding that following the restrictions placed by China on imports from the US firm Micron, South Korean companies may not rush to fill that void. The summit outcome documents did not, however, dwell on these particular issues and the joint statement restricted itself to stating the two sides will continue consultations towards encouraging mutually beneficial corporate investment in the US by creating predictable conditions for business activities.

India and the US discuss export control issues

During the visit of US Assistant Secretary for Export Administration Thea D.Rozman Kendler to India in the last week of April, the two sides discussed export control issues related to items of dual use, apart from also engaging in the planning for the India-US Strategic Trade dialogue to be held in Washington D.C. in May 2023. She indicated that there were also roundtable discussions with Indian industry, including the Indian Semiconductors Association, the US-India Business Council, NASSCOM and the American Chamber of Commerce. Prior to these meetings, the US Department of State's Export Control and Border Security, and the US Department of Commerce's Bureau of Industry and Security, hosted a US-India space technology industry workshop on export controls from April 24-25 in Bangalore.

US-Japan critical minerals agreement

USTR Katherine Tai and Japan's Ambassador to the US Tomita Koji signed a critical minerals agreement on March 28, 2023 intended to facilitate trade, promote fair competition and market oriented conditions for trade in critical minerals[2]. This establishes certain new commitments and avenues for cooperation regarding electric vehicle critical minerals supply chains. The agreement provisions, that could become a template for similar future agreements, included the following:

- Non-imposition of export duties on critical minerals;
- Domestic measures to address non-market policies and practices of third countries affecting trade in critical minerals;

[2] See https://ustr.gov/about-us/policy-offices/press-office/press-releases/2023/march/united-states-and-japan-sign-critical-minerals-agreement

- Best practices regarding review of investments within their territories in the critical minerals sector by foreign entities;
- Measures that promote more resource efficient and circular economy approaches to reduce the demand for, and environmental impact of, virgin material extraction and related processes;
- Engagement, information-sharing, and enforcement actions related to labor rights in critical minerals extraction and processing;
- Remedying violations of labor rights at entities connected to critical minerals supply chains; and
- Promoting employer neutrality in union organizing and operations.

US Treasury Secretary Janet Yellen clarifies US approach towards China

In a speech on the US-China Economic Relationship that she gave[3] at the Johns Hopkins School of Advanced International Studies on April 20, US Treasury Secretary Janet Yellen spoke about this relationship based on sober realities. She drew attention to China's decision in recent years to pivot away from market reforms toward a more state-driven approach that had undercut its neighbours and countries across the world. China, she said, was also striking a more confrontational posture toward the United States and its allies and partners – not only in the Indo-Pacific but also in Europe and other regions.

On the US's approach to the economic relationship with China, she laid out three principal objectives. First was to secure the US's national security interests and those of its allies and partners, and the protection of human rights. National security came first even if it had an impact on the economic relationship with China. At the same time, she added that while tagetted actions taken by the US to protect its interests may have economic impact, they were motivated solely by "our concerns about our security and values"; were not meant to give the US a competitive economic advantage over China or to stifle China's economic and technological modernisation.

Second, the US was seeking a healthy economic relationship with China. A growing China that played by international rules would be good for the United States and the world. In this regard she said that the US and its allies will continue to press China on its unfair economic practices and take coordinated actions like 'friend-shoring' supply chains to mitigate vulnerabilities. Yellen also said that US was not seeking to decouple from China and added that a full

[3] See https://home.treasury.gov/news/press-releases/jy1425

economic split between China and the US would be disastrous for both countries and destabilising for the rest of the world.

Third, the US will seek cooperation with China on urgent global challenges of the day, including on debt overhang and climate change.

NSA Jake Sullivan brings out the larger context of the US approach

In an address delivered at the Brookings Institution in Washington D.C. on April 27, within a week of Yellen's speech, and themed on 'Renewing American leadership', US National Security Adviser Jake Sullivan laid out the wider context arising from the interlaced fundamental challenges facing America on the economic, strategic and national security fronts. He also outlined several steps being taken by the Biden Administration in dealing with them, observing that he was zooming out of Yellen's speech and integrating domestic policy with foreign policy. Among the challenges he laid out were:

- America's industrial base had been hollowed out. Promises about benefits of deep trade liberalisation were not kept;
- Geopolitical and security competition was having an important economic impact. A large non market economy, China, had been integrated into the trading and economic world in a way that posed considerable challenges. Economic dependence had become perilous from supply chain vulnerabilities in medical equipment, semiconductors and critical minerals. The US now manufactured only 10% of the world's semiconductors , 4% of lithium, 13% of cobalt, 0% of nickel, and 0% of graphite needed for electric vehicles, whereas more than 80% of critical minerals were processed by one country, China;
- A climate crisis that urgently needed clean energy transition; and
- The challenge of inequality and its damage to democracy.

Sullivan elaborated the following steps set in motion by the Administration:

- Implementing a modern American industrial strategy as a foundation stone with the help of the IRA, the Chips Act etc. Large scale investments have already come into the US in semiconductors and clean energy production. It was estimated that public capital and private investment may amount to US$ 3.5 trillion over the next decade;
- Working with partners to ensure they are building capacity, resilience, and inclusiveness. Sullivan referred in this regard to several ongoing initiatives

with the EU, Canada, Japan, Republic of Korea, India and Taiwan, among others;

- Moving beyond trade deals to those covering core current challenges including supply chains, clean energy transition, open and safe digital infrastructure, stopping a race to bottom on corporate taxation and enhancing labour and environment protection (he cited IPEF in this regard);
- Mobilising trillions of dollars in investments into emerging economies, including through improvisations in the operating models of multilateral banks; and
- Protecting foundational technologies with a small yard and a high fence, screening of foreign investments in critical areas relevant to national security, and also addressing outbound investments in sensitive technologies with a core national security nexus. These measures were carefully tailored and they focussed on a narrow slice of technology and a small number of countries that were intent on militarily challenging the US.

On China, borrowing from EU Commission President von der Leyen's speech in Brussels on March 30, Sullivan underlined that US was for derisking and diversifying, and not decoupling.

Chinese company offers to invest in lithium mining in Afghanistan

In another instance of Chinese companies scouting around for investments in Lithium, a Chinese company Gochin has expressed its interest[4] in investing US$ 10bn in Afghanistan's lithium deposits. In its statement of interest, the company has reportedly said the investment will create 120,000 direct and a million indirect jobs in the country. The company would repair the Salang Pass within seven months and carve another tunnel through it.The company also stressed that the processing of the lithium deposits will be done inside the country, for which a hydroelectric dam will be built, and the Kunar-Laghman road will be asphalted.

IRA of US is attracting Chinese renewable companies as well

Despite the prevailing tension in US-China trade ties and the attendent penal tariffs (or perhaps because of it), Chinese solar and other renewable firms that are facing difficulties exporting their products to the US are[5] investing in the

[4] See https://thefrontierpost.com/chinese-company-offers-10b-investment-in-afghanistans-lithium-deposits/
[5] See https://www.taipeitimes.com/News/biz/archives/2023/04/03/2003797204

US to access the market, while also benefitting from the incentives under the IRA Act that seeks to promote clean energy manufacturing. Three Chinese companies are already building solar plants in the US: JA Solar Technology Co. in Arizona, Longi Green Energy Technology Co. in Ohio, and Jinko Solar Co. in Florida. A wind turbine making company, Ming Yang Smart Energy group, is also exploring whether to establish production and research facilities in the US.

China's police questions US consultancy firm at its Shanghai office

China's police authorities have visited the Shanghai office of the US consultancy firm Bain to question their staff. While the company has said it is cooperating, this comes after another US consultancy company Mintz was raided in Beijing in March, following which some local staff were held and the company's operations shut. Mintz offered due diligence services, background checks and asset tracing for its clients. These developments appear also related to some amendments incorporated recently to the espionage law in China, which has widened the scope of the kind of materials and data that are deemed relevant to national security.

As also reported in the March issue of this review, the Chinese government has also opened an investigation into US memory chip company Micron, citing national security risks. The President of the American Chamber of Commerce in China has reportedly said[6] "The Chinese government has continuously said it welcomes foreign investment. However, a flurry of recent actions taken against US enterprises in China has sent the opposite message."

Implementation of the US CHIPS and Science Act makes progress

US Commerce Secretary Gina Raimondo released a paper on April 25, 2023 outlining a vision and strategy for establishing a National Semiconductor Technology Centre (NSTC) provided for in the US CHIPS and Science Act adopted by the US Congress last year for boosting domestic manufacturing of advanced semiconductors. NSTC is to ensure that US led the way in the next generation of advanced technologies, enabling progress in areas that will also advance US national and economic security. The paper also stipulates that "while the manufacturing incentives of the Act will bring semiconductor manufacturing back to the US, a robust R&D system led by the NSTC will keep

[6] See https://www.bbc.com/news/business-65408021

it here". The vision and strategy paper inter alia outlined three high level goals for NSTC:

* Extend America's leadership in semiconductor technology;
* Reduce the time and cost of moving from design idea to commercialisation; and
* Build and sustain a semiconductor workforce development ecosystem.

The NSTC is to be established through the creation of a public private consortium.

Next IPEF negotiating round to be held in Singapore

The third round of IPEF negotiations is to be held in Singapore from May 8-15, 2023. So far, two negotiating rounds have been held, in Brisbane in December 2022 and in Bali in March 2023. In between, a Special negotiating round was also held in New Delhi that focussed on Pillars II-IV but not trade (India has so far stayed away from the trade pillar).

The current status in the negotiations appears to be that a negotiating text for Pillar II (Supply Chains) and Pillar IV (Fair Economy) were made available in advance of the Brisbane round, and for Pillar III (Clean Economy) in advance of the special negotiating round in New Delhi.

As for Pillar I on trade, negotiating texts were made available prior to the Brisbane round on trade facilitation, agriculture, services domestic regulation, and transparency, good regulatory practices and inclusivity. Prior to the Bali round, negotiating texts were also shared for the following topics: labor, environment, digital trade, and technical assistance. This apparently leaves out only competition on which a text is not available yet.

Considering that Korea has already offered to host the fourth round of IPEF negotiations after Singapore, it does appear that these discussions are being actively followed up. However, with details about the negotiating texts and the discussions thereon remaining confidential, it remains difficult to arrive at any assessment about their scope or the progress that has been made.

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