

# Comments on “The Impact of US-driven Geo-economic Fragmentation and Economic Nationalism”

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## Summary

- Comprehensive and intriguing analysis of the future direction of US policies and their impact on foreign countries and regions.
- Timely discussion. Many Japanese people are interested in who will become the next U.S. President and how the US will engage with the international community in the future.
- The opinions I found particularly interesting (slides #12, #13, #14):
  - The direct differences between a Harris or 2<sup>nd</sup> Trump Administration on trade, FDI, and migration will be **only in magnitude**.
  - **Export controls and sanctions will be much more aggressive and strictly enforced under Harris** than under Trump.

# Recent tightening of export control regulations

- US
  - August 2018: The Export Control Reform Act (ECRA) enacted.
  - May 2019: Huawei and its 68 affiliates were added to the **Entity List**.
  - May-August 2020: The Foreign Direct Product Rule (**FDPR**) was strengthened
    - ✓ Even firms outside of the US have to obtain permission if products using US-origin technology or software (“direct products”) are exported to firms on the Entity List. → **Exports from Japan by Japanese firms may be subject to the US restrictions.**
  - August-October 2022: **CHIPS & Science Act** enacted. Export licenses from the US government possibly required for certain products (including semiconductor manufacturing equipment) to **all companies in China**.
- Japan
  - December 2020: Export controls tightened in response to the US move to strengthen export controls.
  - May 2023: In response to the US CHIPS & Science Act, 23 items, mainly semiconductor manufacturing equipment, added to export control list.

## Limited impact of tighter export controls on trade

- Based on the findings in recent empirical studies, **tighter export controls and regulation of technology by the US may not produce the results intended by the US.**
1. The decline in exports to China from the US, Japan, South Korea, Taiwan and other countries has been limited to a few items, with **a limited impact on trade**. ← “small yard, high fence”
  2. Direct investment into China has declined significantly. While direct investment from Japan into China, declined, **more than 60% of Japanese firms already operating in China will expand or maintain their business in China** (JETRO Survey in March 2024).

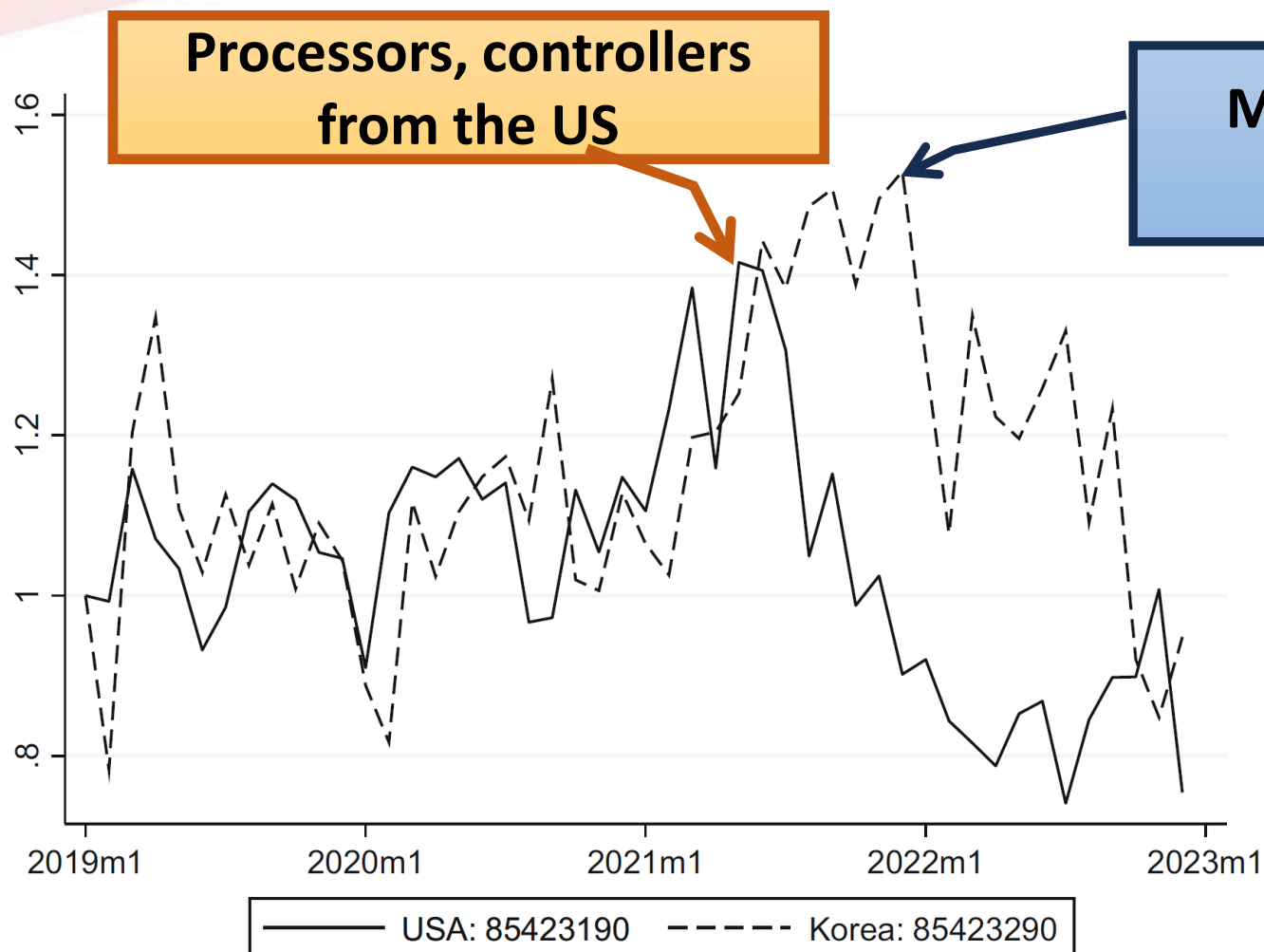
## Limited impact of tighter export controls on trade ---*continued*

3. No strong evidence that exports and sales to China of Japanese firms that are major suppliers to Huawei have been negatively affected.
  - Loophole? Securing alternative sales outlets?
  - Huawei spun off sub-brand Honor to survive US supplies ban. NVIDIA is also developing a model for China and trying to circumvent regulations.
4. The impact of technological decoupling between the US and China on national economies depends on the assumptions and scenarios of the simulation analysis.
  - In the case of Japan, if the country returns to the domestic market and imports from China decrease, then the negative impact will be small?
5. **Tighter technology regulations may also encourage innovation in China.**

## No overall negative impact on exports to China

- Tighter export controls have a negative impact on exports of certain detailed items, but no overall impact.
- The strengthening of the US FDPR had some negative impact on Japan's exports to China for ICT-related products.
  - Hayakawa et al.'s (2023) estimates: The US FDPR reduced exports **by 0.2% of the total value of exports** from Japan to China in 2019.
  - Ando et al.'s (2024) estimates: The US FDPR reduced exports by **3% of the total value of machinery exports** from Japan to China in 2019.
- Exports of processors and controllers from the US to China started to decline from mid-2021, and exports of memory from South Korea to China started to decline from 2022. **No conspicuous reductions in exports from Japan and Taiwan to China.** (Ando et al. 2024)

## China's imports of integrated circuits (HS8542) January 2019=1

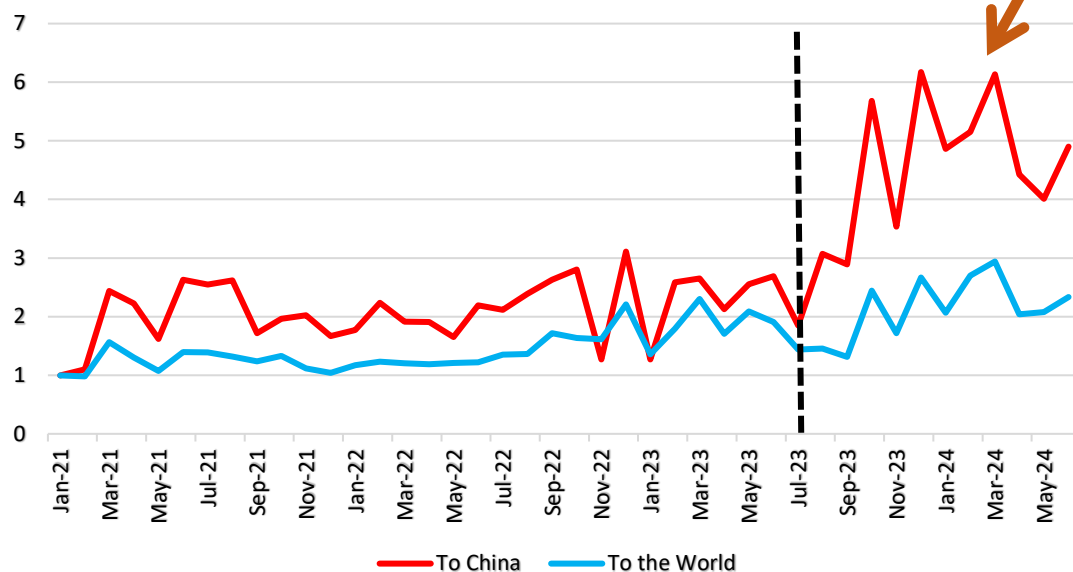


# Japan's exports of semiconductor manufacturing equipment to China do not decline.

Japan's exports to China increasing

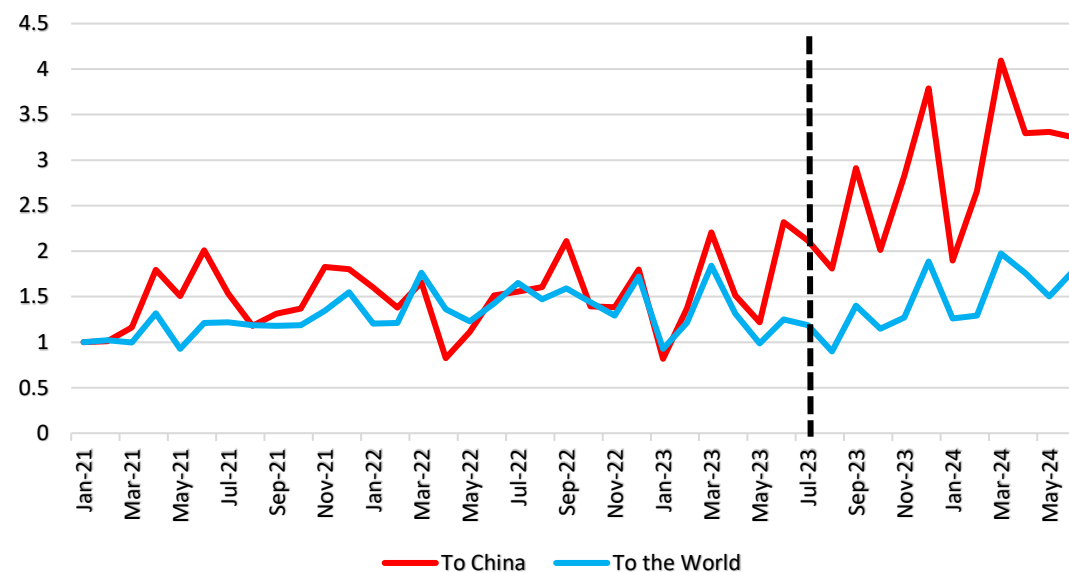
Machines and apparatus for the manufacture of boules or wafers

HS 8486.10 (January 2021=1)



Machines and apparatus for the manufacture of semiconductor devices or of electronic integrated circuits

HS 8486.20 (January 2021=1)



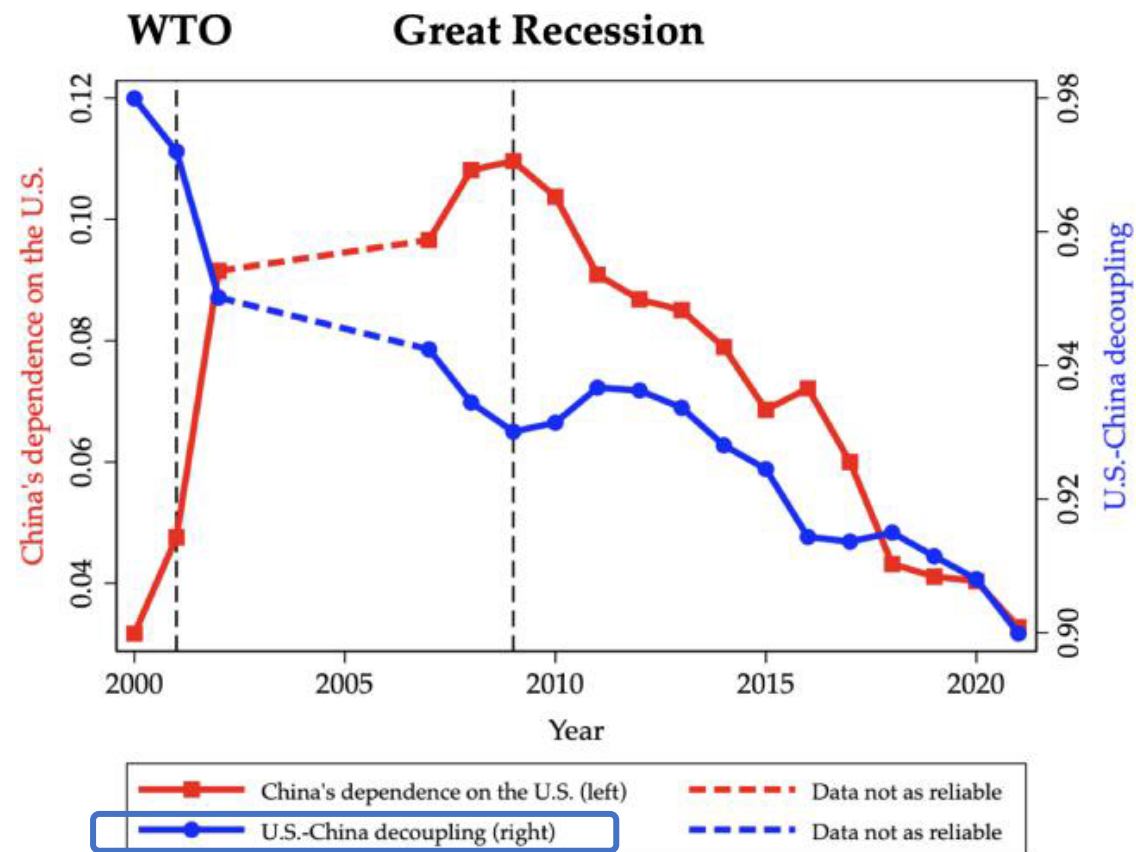


## Simulation results vary widely depending on what scenario is assumed

- Simulation results on the impact of technology decoupling between the US and China vary widely depending on what scenario is assumed.
- Simulation analyses based on general equilibrium models increasingly carried out
  - Garcia-Macia and Goyal (2020), Cerdeiro et al. (2021), Kumagai et al. (2023), Campos et al. (2023), Góez and Bekkers (2022), Jinji and Ozawa (2024), etc.
- **The impact on each country's GDP and exports will vary depending on various conditions**, such as the extent of export restrictions, the extent to which third countries follow the US and China, how the magnitude of technology spillovers through trade is estimated, and how much the reduction in direct investment is taken into account.
  - If the US government narrows the scope of regulation in an attempt to minimize the negative impact on its own economy, the impact on third countries may not be too large.

# US-China decoupling may encourage Chinese firms to innovate

- Han et al. (2024), using the patent citation data, measure the technological dependencies and decoupling between the US and China.
- China's technological dependence on the US has been declining, and the US-China decoupling has been declining, too (**deepened technological relationships**).



Han et al. (2024) Figure 4

## US-China decoupling may encourage Chinese firms to innovate --- *continued*

- Han et al. (2024) analyze the impact of US sanctions against China since 2000 (additions to the entity list) on the performance of Chinese and US firms (using CSMAR and Compstat data).
- Negative impact on a Chinese firm's innovation, productivity and profitability if its own industry or upstream of own industry is sanctioned.
- However, **if downstreams of own industry are sanctioned, the own innovation is promoted.** ← Attempt to acquire new technology in order to sell their products to a different company or a different industry to the sanctioned one?

## Requests to the US government

- Clarification and transparency of policy and regulatory content. How high is the “high” fence? How small is the “small” yard?
- It is particularly difficult for foreign firms to obtain information on the US FDPR, which discourages foreign firms from engaging in exports to/businesses in China.
  - The JETRO survey also shows that collecting regulatory information is a key challenge for Japanese firms and a burden for them.
- The undermining of the rules-based international trade order is being promoted by the major powers, the US and China, leading to the loss of confidence of Japan and ASEAN in the US.
  - Already in trade, ASEAN-China relations have deepened significantly (Slide #23). According to the State of Southeast Asia Survey 2024 compiled by the ISEAS-Yusof Ishak Institute, ASEAN is now more pro-China than US (50.5% vs. 49.5%).
- The disregard of the international community also encourages foreign countries to move away from the US.

## Requests to the Japanese government

- While the importance of the US-Japan relationship goes without saying, Japan, as a representative of middle power, should play a central role in supporting a rules-based international trade order.
  - Japan is a member of the CPTPP (which the US is not a member of, but China is applying for membership), RCEP (which the US is not a member of) and IPEF (which China is not a member of).
- The Japanese Government should also be aware of the rapidly growing close relationship between ASEAN and China and the fact that overseas Chinese have always controlled ASEAN's economy.
- The importance of developing human resources with a deep understanding of international relations has been recognized for a long time, but it is still insufficient.
  - It is important to fundamentally review public education, especially higher education, in order to raise its standards to international standards.

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