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MERICS Report

From opportunity to risk

The changing economic security policies in Australia, China, the EU, Japan, South Korea, the UK and the US

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Governments are advancing "economic security" to adjust to a shifting geopolitical and geoeconomic environment

The scope of what is considered "economic security" is expanding

- **Traditionally, economic security policies have been defensive and dealing with aspects of trade and investment that can threaten national security.** For example, the export of weapons or the investment by a foreign entity in another country's military production.
- **Current policy developments are developing offensive[1] policies and merging economic security with resilience.** All to make sure that not only countries are not exposed to security risks, but also that their economies are resistant to shocks and weaponization by third countries.

This expansion is mainly triggered by China and an erosion of rules-based globalization

- **The erosion of the international rules-based order and of its institutions** (including the impossibility to bring forward necessary reforms such as that of the WTO) **and the perception of a zero-sum competition between the US and China** are incentivizing actors to adopt an approach to economy that prioritizes protection of own interests over collective gains.
- **China's heavy subsidization of its enterprises, sweeping industrial policy, strategic use of foreign policy to advance economic goals and weaponization of economic linkages to pressure third countries are driving the expansion of economic security measure.**

"Economic security" is one of the most dynamic policy arenas, not only of like-minded action and coordination

- **Between 2017 and 2022, actors unilaterally strengthened defensive and offensive economic security policies.** Since 2017 defensive policies such as inbound foreign direct investments (FDI) screening, export controls, cybersecurity and data protection, and offensive policies such as sanctions and supply chain resilience have been strengthened.
- **Past economic security policy debates mainly regards the improvement of actors' resilience.** Developments in 2023 will include debates about polices on further strengthening supply chains resilience, how to deter and respond to economic coercion, screening of outbound investments and institutionalization of the economic security agenda.

[1] "Offensive" means any policy that does not exclusively elaborate a defensive response to a threat, but a policy that has or includes a proactive agenda

Economic security measures are proliferating – with different intensity

	CHINA	US	EU	UK	JAPAN	AUSTRALIA	SOUTH KOREA
Inbound investment screening	Strong	Strong	Moderate	Moderate	Moderate	Moderate	Moderate
Outbound investment screening	Moderate	Under discussion	None	None	Weak *	None	Weak *
Export controls	Moderate	Strong	Strong	Strong	Strong	Moderate	Strong
Procurement restrictions	Strong	Strong	Moderate	Moderate	Moderate	Moderate	Moderate
Sanctions	Strong	Strong	Moderate	Moderate	Moderate	Moderate	Weak
Anti-coercion policy	None	Under discussion	Under discussion	None	None	None	None
Supply-chain resilience policies	Moderate	Strong	Moderate	Moderate	Strong	Moderate	Strong
Data protection and cybersecurity	Moderate	Moderate	Strong	Strong	Strong	Moderate	Strong
Institutionalization	None	None	None	Weak	Strong	None	Moderate
Industrial strategy	Strong	Strong	Moderate	Weak	Strong	Weak	Strong

Legend

- Strong
- Moderate
- Weak
- Under discussion
- None

Notes: *Minor restrictions in place for foreign banks, weapons manufacturing, and narcotics, but they are residuals of processes of economic opening and not full-fledged policies to screen outbound investments.

**Criteria used to assign colors can be found in the Appendix.

Source: MERICS

Managing interdependence for security reasons has been a long-standing feature of China's economic policy but is currently in overdrive

SELECTED POLICIES	ECONOMIC SECURITY FOCUS
China Government Procurement Law (中华人民共和国政府采购法)	The revised draft of the law adds to the scopes of the policy that of maintaining national security. It also foresees the establishment of a security review system to review government procurements that may have an impact on national security.
Foreign Trade Law (中华人民共和国对外贸易法)	The state can impose import and export quotas and licensing for goods and technologies, and the items involved can only be imported or exported only after approval from the Ministry of Foreign Trade.
Foreign Investment Law (中华人民共和国外商投资法)	It sets up a review mechanism for foreign investments that includes a security-specific review system to screen investments that may have an impact on national security.
Personal Information Protection Law (PIPL) (中华人民共和国个人信息保护法) **Data Security Law** (中华人民共和国数据安全法)	They regulate data export, storage, protection and localization. The Data Security Law establishes a classification of data on its potential impact on national security.
Draft Foreign Relations Law (中华人民共和国对外关系法)	The draft law seeks to create a legal framework to "safeguard China's sovereignty, security, development interest [..]".

KEY DRIVERS OF CHINA'S ECONOMIC SECURITY POLICYMAKING

1) **Increased perception of a hostile external environment.** The perception of a zero-sum competition with the US and the need to "resolutely win the battle of key core technologies" (坚决打赢关键核心技术攻坚战).
2) **View of economic security as a cornerstone of China's national security.** "Political security [..] is the "bedrock" (根本). Economic security is the "basis" (基础). Military, cultural and social security are the "guarantees" (保障)".
3) **Desire to create comprehensive legal frameworks.** The legal formalization of practices and the strengthening of China's legal frameworks are a key element of China's governance under Xi Jinping ("rule by law"). To some extent this is also a respond to international requests for legal transparency and certainty.

Sources: MERICS, NPC Observer, MOFCOM, China Law Translate

Beijing's economic security toolbox is expanding rapidly, too

EXPORT CONTROL LAW (ECL)	**The Export Control Law embodies China's focus on economic security.** Upholding national security and national interest is the main scope of the provisions included in the law.	It is China's first comprehensive export controls legal framework. **It establishes "controlled items"**, which includes dual-use, nuclear and military goods, services and technologies.	**The list in non-exhaustive.** the State Council and the Central Military Commission can add other items **It has jurisdiction outside of China** by including responsibilities and penalties for foreign importers.
CHINA'S ADMINISTRATIVE MEASURES FOR ENTERPRISE OUTBOUND INVESTMENTS (AMEOI)	**The AMEOI is an example of a policy adopted with a double intent.** (i) increase overview and scrutiny over outbound investments, (ii) provide a regulatory framework to an under-regulated practice.	It provides **criteria for enterprises and improves control investments made by state-owned enterprises** and their subsidies. SOEs must receive SASAC's approval before notifying an investment to the National Development and Reform Commission (NDRC).	**Sensitive regions**: (i) countries without diplomatic ties to China; (ii) areas facing unrest; (iii) sanctioned areas. **Sensitive industries** include military equipment; weapons; telecommunications; media; energy; and real estate.
CHINA'S ANTI-FOREIGN SANCTIONS LAW (AFSL)	**The AFSL illustrates how China has been adopting policies to prepare itself to a „worst case scenario" in a geopolitical climate perceived as hostile.**	It provides **the legal basis for sanctions** that China was already adopting (interference in internal affairs) and for a new counter-sanctions regimes.	**Companies operating in China complying with foreign sanctions against China can be sanctioned by China.** And entities affected by foreign sanctions can sue for compensation.

Sources: MERICS, NPC Observer, China Law Translate

Like-minded responses I: Supply chain resilience

Most governments are still mapping vulnerabilities and planning how to address them

STATE OF AFFAIRS

Following the pandemic of Covid-19 and the subsequent supply chains disruptions, most countries have commenced a process to assess vulnerabilities in their supply chains and adopt policies to manage them.

The EU made a first **assessment of its strategic dependencies** in 2021, followed by a second in-depth evaluation of five areas in 2022: rare earths, chemicals, solar panels, cybersecurity and IT software.

Coordination with partners ★★★☆☆

The US-led Mineral Security Partnership brings together global partners in a framework that seeks to strengthen the supply of critical material. It includes Australia, Canada, Finland, France, Germany, Italy, Japan, the Republic of Korea, Sweden, the United Kingdom, and the European Commission.

FRONT RUNNING POLICIES

Japan's Economic Security Promotion Act.
Includes a six-step item-specific process to ensure the security of critical items: (i) designation of critical items, (ii) action plan for each item, (iii) companies formulate operation plan, (iv) application by company, (v) government approval, (vi) funding.

South Korea has been identifying overdependencies from foreign countries with a quantitative focus.

If Korea's dependency for a specific item is >50% then it will monitor the item and include it in a list of items for an early warning system in case of supply disruption. The country identified around 4000 items, and it has been further expanding the criteria for the assessment, adding another 200 items. The full list is not publicly available as Seoul prefers to plan how to manage such vulnerabilities (i.e., stockpiling and diversification) without advertising them.

OBSTACLES AND SOLUTIONS

Obstacles: Lack of business participation.

- A common obstacle faced is the necessity to get the businesses on board with policies that limit their space of maneuver.

Solutions: Introducing incentives.

- South Korea is opting for a system of incentives in the form of financial assistance to companies to stockpile and diversify.
- Japan is also offering similar incentives to companies who present strategies to increase their resilience to economic disruptions.
- Link products groups together to increase resilience in case of disruptions of supply chains.

Like-minded responses II: Protection against economic coercion

The EU and the US are the only ones proposing large-encompassing regulation against economic coercion

STATE OF AFFAIRS

Economic coercion has been on the rise. China has been one of the main perpetrators and the adoption of unofficial and opaque measures makes it difficult to pursue cases via the WTO. Countries are thus considering alternative solutions.

The EU's Anti-Coercion Instrument (ACI) proposes a framework for the European Commission to assess and respond to economic coercion against the EU and its member states. It does not include compensation for targeted actors.

Coordination with partners ★☆☆☆☆

There is no formal ongoing coordination between partners beyond unofficial exchanges to, for example, find a common definition of economic coercion.

FRONT RUNNING POLICIES

The US Countering Coercion Act (2022).

Proposed by US Senators Chris Coons and Todd Young, the Act focuses on helping third countries and coordinating with partners to provide a united response to economic coercion.

The Act would give the President a series of tools to use to promptly support countries hit by economic coercion (i.e., decrease duties and expedite export licensing to reduce the impact of economic coercion on targeted countries).

The EU Anti-Coercion Instrument.

The main scope of the legislation is to deter such behaviors. It envisions a two-steps approach.

1) Solve the issue diplomatically seeking a retraction of the coercive measures.

2) If it does not work, the Commission can adopt measures such as trade and investments restrictions.

OBSTACLES AND SOLUTIONS

Obstacles: Most countries do not opt for ad-hoc policies against economic coercion.

- Australia, Japan and South Korea have been subjected to China's economic coercion but do not have similar instruments in the pipelines. The UK too is not adopting an anti-coercive instrument.

Solutions: Establishing a multilateral system with voluntary buy-in by countries.

- Create a platform and process to propose, discuss and adopt responses multilaterally. The action could be like that adopted in response to economic coercion by China towards Australia or Taiwan (i.e., buy more of the banned products) or include potential voluntary financial compensation.

Like-minded responses III: Outbound Investment Screening

Most countries are yet to officially consider the adoption of a policy to screen outbound investments

STATE OF AFFAIRS

All the actors selected have been adopting or strengthening their inbound investment screening and the EU's regulation is due for reviewing in 2023.

The European Commission has included a debate on a potential outbound investments screening mechanism in its work program for 2023.

Coordination with partners

The US is the only actor analyzed here to have proposed a fully-fledged policy to screen outbound investments. With the EU officially dealing with the matter in 2023 and other countries such as Japan and South Korea weighing the usefulness of such a policy, more coordination can be expected in 2023.

FRONT RUNNING POLICIES

The US National Critical Capabilities Defense Act (NCCDA).

US senators Bob Casey (and John Cornyn - proposed the NCCDA. The White House has signaled support in an executive order in September 2022. But the debate on screening outbound investments emerged already in 2018 when the US was working on the Foreign Investment Risk Review Modernization Act (FIRRMA).

The US is an innovator in proposing a new outbound investments screening mechanism that would impose new restrictions to the outflow of capital. The proposed NCCDA seemed to be going beyond the screening of direct investments and include any US capital invested in China, Russia, North Korea, Iran, Cuba, and Venezuela that could not only potentially pose a threat to US security, but also contribute to those countries' innovation.

OBSTACLES AND SOLUTIONS

Obstacles: Diversity of legal systems and policy objectives.

- The NCCDA proposed a screening of outbound US capital, not just foreign direct investments (FDI) because US concerns are not limited to FDI. Furthermore, the NCCDA discriminates against a list geographical areas.
- An EU equivalent would be more interested in FDI, and it is likely to remain country-agnostic.

Solutions: Focus on sectors of common concern.

- The sectors identified by the EU as "sensitive ecosystems" provide a good starting point to identifying common ground for coordination on the target areas of an outbound investment screening.

Like-minded responses IV: Institutionalization

Japan and South Korea are frontrunners of institutionalization of the economic security agenda

STATE OF AFFAIRS

Lack of funding is a core issue of economic security institutionalization, but even countries with more funding at their disposal struggle with it. The US too has an economic security agenda scattered between Commerce Department, Treasury and others.

The EU's economic security agenda is scattered amongst different agencies and lack an ad-hoc point of coordination. DG Trade is in the lead for large part of the economic security agenda, but not all of it.

Coordination with partners ★★☆☆☆

The Trade and Technology Council (TTC) has function as platform for Transatlantic coordination and the Quad and 2+2 for multilateral and bilateral coordination amongst partners in the Indo-Pacific. But beyond the G7, there is no platform that unites economic security agendas from the two areas.

FRONT RUNNING POLICIES

South Korea's Foreign Economic Security Strategic Committee and economic security think tank within the Ministry of Foreign Affairs.

It represents a whole of government approach, and it led by the Deputy Prime Minister as Head of the Committee. The new government is seeking to institutionalize such an effort as part of the Supply Chain Basic Law currently under discussion. The law would establish a Supply Chain Stability Committee under the office of the President.

Japan appointed a Minister for Economic Security.

The Minister functions as institutional representative of a multi-stakeholder agenda where the Ministry of Economy, Trade and Industry together with other ministries such as that of education and the **National Security Council** shape and enact the economic security agenda.

OBSTACLES AND SOLUTIONS

Obstacles: Economic security crosscuts different competencies.

- The different competencies were previously dealt with by separate divisions/agencies. An efficient economic security agenda requires cross-sectoral competencies' coordination.

Solutions: Institutionalization of economic security.

- Appointment of point of contact/coordinator for economic security.
- Establishment of ad hoc processes to coordinate all the policy efforts related to economic security, which includes the involvement of other specialized agencies and ministries that contribute to the economic security agenda.

Liberal-democratic governments face three critical tensions in designing their economic security policies

NATIONAL SECURITY VS OPEN ECONOMY

- **Economic gains and security costs cannot be neatly separated.**

Countries whose economies were largely open are now **pricing in security considerations and introducing new restrictive measures** (i.e., the EU, US, UK and Australia). Countries who were opening their economies have adapted the process to a **more selective approach** that considers where to open up and where to protect assets (i.e., South Korea and Japan).

- **Institutionalization of economic security offers a solution.**

One way to offer a balanced synthesis of economic and security drivers is to have a point of contact for economic security. The second step should be to develop an agency where personnel includes economy and security staff as well as staff with knowledge in economic security.

UNILATERAL VS MULTILATERAL

- **Actors face the dilemma of adopting unilateral policies that may boost home economy but have undesired effects on partners.**

The US Inflation Reduction Act (IRA) and industrial policies focused on semiconductors (i.e., the EU's Chips Act, the US' CHIPS and Science Act , Japan's Economic Security Promotion Act and South Korea's Chips Act) compete with one another rather than seeking synergies.

- **A truly multilateral initiative for economic security is needed.**

The TTC, the Quad, and the G7 offer existing spaces to coordinate policymaking but are exclusive. initiatives such as the **Mineral Security Partnership** should grow in number and be embedded in a broader multilateral framework of collaboration for **collective economic security,** similar to the Indo-Pacific Economic Forum but conceptualized and led multilaterally.

CHINA-SPECIFIC VS COUNTRY-AGNOSTIC

- **China-related considerations drive the economic security policymaking. But approaches differ.**

The US explicitly views relations with China increasingly through the prism of national security threats, which influences the content of policies. Many other actors' approaches to China come to a different assessment of the balance of risks and opportunities.

- **Country-agnostic policies should remain the main approach.**

The downsides of a country-agnostic approach are a) partners may worry that a policy will be used against them; b) policies require more energies and capital because they are not geographically targeted. The main advantage is that it leaves more room for maneuvering for the country adopting the policy without necessarily sacrificing effectiveness.

How the EU strikes a balance regarding these tensions will have global implications

NATIONAL SECURITY VS OPEN ECONOMY

UNILATERAL VS MULTILATERAL

DIFFERENT CHINA STRATEGIES

- **The EU's Open Strategic Autonomy** is a fitting conceptual framework for EU's economic security policymaking. It is present in the Commission work to assess EU's strategic dependencies and it can inform an approach to economic security that places resilience at its center, rather than just national security.
- Open Strategic Autonomy should thus be used for policies, new and under review. For example, to screen inbound and outbound investments in/by strategic companies/sectors that **do not pose immediate national security threats but increase EU's vulnerabilities and weaken the block's resilience.**
- **The fragmentation of the economic security agenda not only occurs amongst countries but also within them**. With the notable exception of Japan, and partially South Korea, other countries see the economic security agenda scattered amongst different agencies according to the policy issue area.
- **The Commission should have a dedicated unit for economic security with a head in charge for coordination within the EU.**
- **The EU should proactively drive and/or contribute to the establishment of the creation of a multilateral platform and process to coordinate the economic security agenda of Transatlantic and the Indo-Pacific partners.**
- **Pressure to produce policies directly targeting China is likely to grow.** To improve the EU's position in such a debate without sacrificing collaboration and coordination with partners, the EU could elaborate a China strategy that is better actionable and better delineates priorities.
- **A more actionable and clearer China Strategy does not mean adopting ad-hoc economic security policies for China.** Instead of targeting China, the EU can continue focusing on issue-areas like it has done in the past. Such an approach still reduces the risks posed by China without leading to unnecessary diplomatic escalations.

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