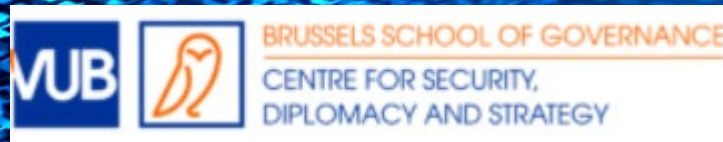




Friend-Shoring: Security Trumps Economics? A European perspective

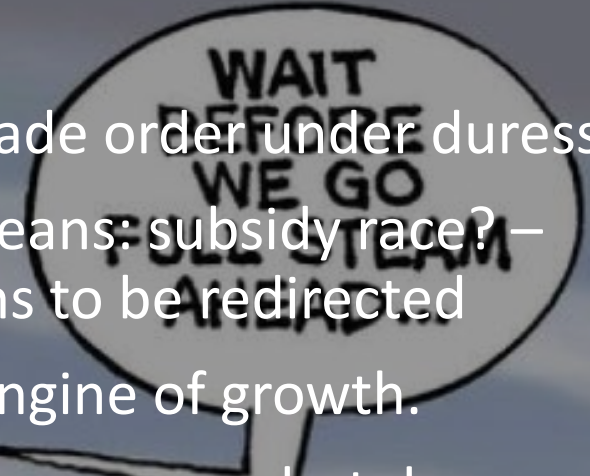
Michael Reiterer

Distinguished Professor, Brussels School of Governance, CSDS



Challenges weakening the established order

- WTO-centred multilateral trade order under duress,
- industrial policy by which means: subsidy race? – supply and production chains to be redirected
- World trade no longer the engine of growth.
- The heydays of globalization are over, but decoupling no viable option – a new system in the making, back to might is right?
- Protectionism globally increasing: strategic sovereignty, strategic autonomy, resilience, autarky...
- Instrumentalization or weaponisation of trade and investment, technology
- Fragmentation of world trading / economic system (de-coupling, de-risking, near-, re- friend-shoring)



Geo-economics meets geo-politics

- Element of **like-mindedness** in rendering supply, production and value chains more secure and resilient -> need for international governance based on common understanding
- **Reshoring, near-shoring, friend shoring** and **strategic autonomy, economic sovereignty** indicate that the hey days of globalisation are over politically – the crisis of the WTO as a symptom
- **De-coupling, de-risking, delinking , de-globalising, de-dollarisation: bloc building and reciprocity** replacing **multilateralism, country X first**
- An **alliance of democracies** is not an economic or trade concept
- **Weaponisation of policies:** trade (economic statecraft), technology, migration...
- **Pursuing interests** within a rules-based order, no law of the jungle
- Building a **new order** in reforming and developing the present one

Need for cooperation, rule setting

1) Regulating **data**, the new lifeline of the economy

- **GDPR** General Data Protection Regulation
- **Digital Partnership Agreement**
- **Cybersecurity** - critical infrastructure

2) **Rare minerals** for new, emerging technologies: new dependencies in the making?

3) **Singapore issues re-enter focus of attention: Social Policy:**

sustainable development section of FTA: ILO Conventions; products made with **forced labour**

4) **Green financing**: taxonomy to define “green” for finance & trade

Need for cooperation

5) Preserving **multilateralism**

- Getting **WTO** back on track with improvements – Dispute Settlement
- **plurilateral agreements** as stepping stones, not permanent solutions
- “**Frameworks**” below the level of FTAs not be used to escape WTO control

6) Need for framework to deal **with industrial policies**:

- Subsidies
- Anti-dumping
- Competition law: which reference market, subsidies

7) **Trade defence, anti-coercion law, proposed Economic Security Strategy**

European Economic Security Strategy



Commission européenne
European Commission

proposes to carry out a thorough assessment of risks to economic security:

1. risks to the **resilience of supply chains**, including energy security;
2. risks to **physical and cyber security of critical infrastructure**;
3. risks related to **technology security** and technology leakage;
4. risks of **weaponisation** of economic dependencies or economic coercion.

EU Economic Security Strategy

sets to mitigate identified **risks** through a three-pronged approach by:

- **promoting the EU's competitiveness**, by strengthening the Single Market, supporting a strong and resilient economy, investing in skills and fostering the EU's research, technological and industrial base;
- **protecting the EU's economic security** through a range of existing policies and tools, and consideration of new ones to address possible gaps. This would be done in a proportionate and precise way that **limits any negative unintended spill-over effects** on the European and global economy;





EU Economic Security Strategy & diplomacy

- **partnering** with the broadest possible range of partners to strengthen economic security, including through
 - ✓ furthering and finalising trade agreements,
 - ✓ reinforcing partnerships like connectivity, digital
 - ✓ strengthening the *international rules-based economic order* and multilateral institutions, such as the WTO,
 - ✓ investing in sustainable development through Global Gateway.

Security like foreign policy starts at home

Economic security starts at home:

- **robust economic performance**, Single market as strength, renationalisation as danger
- **Leadership in critical technologies** , especially at interface with military security
- **Financial Stability** + capacity to mobilise funds: EU Capital Market Union

External dimension: no isolationist concept, engage bi- and multilaterally

Economic Security Strategy needs to be

- **Defensive** of critical infrastructure, access to essentials like energy, raw materials, parts in shared production processes -> market access
- **Offensive** to take counter-measures if necessary, to deter the use of economic statecraft, coercion, blackmail by others
- **Creative** to meet the new challenges without re-nationalising, turning isolationist, becoming protectionist, replacing multilateralism by bilateralism, rules by force, right by might ->
- **Need for reform**, no status-quo defence, equip the rules-based system with workable rules through updates (IPR, investment), new rules (data, cyber, e-commerce, AI, health (pandemic preparedness))
- ...



Friend-shoring

- At a first glance, **friend-shoring** has a certain appeal – sourcing from and producing in partner countries sharing political ideas reflecting like-mindedness to mitigate supply chain disturbances, and de-risking to bring security through trust.
- It is the same thinking which is behind President Biden’s Summit for Democracy and the idea rooted in Immanuel Kant’s Eternal Peace, “that liberal democracies do not engage in wars against each other”.



- Friend-shoring covers somehow the middle ground between decoupling and de-risking, incorporating elements of both concepts.
- While **de-coupling** is the radical approach, severing of relationships and building up new ones to reduce dependencies, **de-risking** is a more gradual process mitigating risks through broadening relationships, whether on the import, export or investment or technology side.
- **Selective, focussed application:** strategic goods and technology; dual use; contingency planning
- In terms of politics, friend-shoring can deepen relationships with partners and allies. In terms of economics, as an instrument of industrial policy, it is interventionist in market. To remedy a market failure?



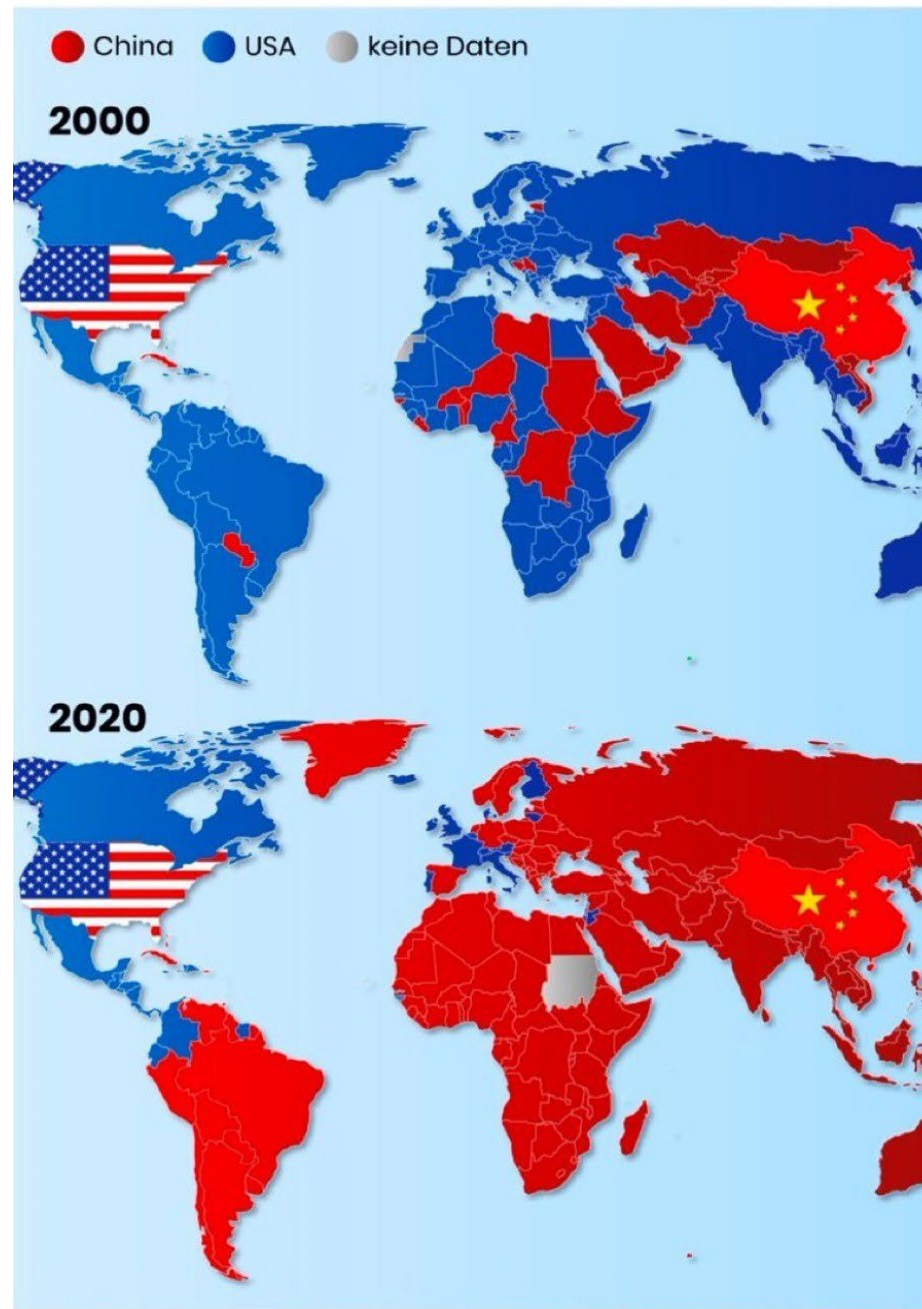
Shortcomings of the concept

- Friends will not be able to provide all the goods and services needed ->
- Cooperation of 'non-friends' will be required to achieve certain goals like climate change and green transition or to procure necessary raw materials or inputs in the production process.
- Efforts to win over as many 'non-friends' as possible, will eventually pay off in terms of security, secure access to critical raw materials, markets and influence in general.
- System based on free and fair competition poses limits to government intervention and Industrial policy.
- The spirit of competition entrenched in market players can induce substitution: If the import of products from a country are banned for political reasons, another country or the businesses of another country may step in
- Example: When China barred Australian wine , European and Chilean wine makers stepped in and gained market shares. When Japan imposed trade restrictions on products needed for the semi-conductor industry in South Korea, Korean companies substituted Japanese products from other sources and ratchet up national production.
- Example positive action: When China barred Taiwanese mangoes , other traders in other countries, like Japan , stepped in.

Who are the friends? Are they forever?

- The leader of a principally friendly nation may take ‘unfriendly’ measures which impact on the interests of the EU. A friend is not above suspicion, no friendship is eternal.
- Example 1: **Inflation Reduction Act** which impacts negatively on Asian and European car manufactures This situation contributed to accelerating the work on the EU’s Economic Security Strategy
- Example 2: **COVID-19**: EU Commissioner Thierry Breton, *“We have also learned that our supply chains are vulnerable to actions by even our closest allies. Remember when in 2021, in the name of the America First principle, the Biden administration started to block access to some of the most crucial ingredients for producing vaccines: we had to weigh in with our export control mechanism to rebalance our relation and restore the vaccine supply chain across the Atlantic.”* (10 January 2024)
- Example 3: **Nippon Steel**: the US government wants a “serious scrutiny” of Nippon Steel buying US Steel for \$14.9 bn “given the company's core role in U.S. steel production that is critical to national security.”
- On top, the possible **return of Donald Trump** does not augur well for ‘friendly’ relations .

Change of number 1 trading partner



Main problems

- **Level playing field** - > rules and regulations have to be applied and be applicable to all, including market access for goods and services: reciprocity: rules you expect others to respect have to be respected in terms of trade and investment; frameworks vs. FTAs
- **Burgeoning bilateral trade deficit:** problematic if the result of lack of level playing field e.g. lack of market access, discrimination, subsidies, dumping ...

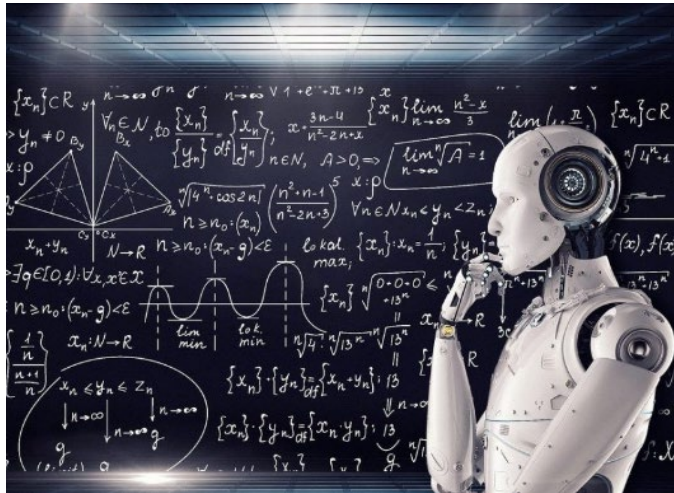
Economic costs

European Bank for Reconstruction and Development (EBRD)

- “Geo-political tensions and disruptions to global value chains have led policy makers to re-evaluate their approach to globalisation. Many countries are considering regionalisation and friend-shoring – trading primarily with countries sharing similar values – as a way of minimising exposure to weaponisation of trade and securing access to critical inputs. If followed through, this process has the potential to reverse the global economic integration of recent decades.”
- Although friend-shoring may provide insurance against extreme disruptions and increase the security of the supply of vital inputs, it would come at a significant cost.” Costs not everybody is either willing or able to bear.
- Cost estimate by EBRD & WTO: 4,6% GDP

Technology

- Competition for technological supremacy has entered vigorously trade policies – Chip Wars stand for this development which is generally linked to emerging technologies.
- Competition for new raw materials: rare earth and minerals, new dependencies compared to fossil energy provider, but no gain in democratic friends.
- The current ‘friend-shoring’ trend is skewed toward technology e.g. exclude others from the state of the art of sensitive technology, limit access to ‘friends’ through export control and limitations on investment, whether in- or outbound.
- This may create a disadvantage for further research and development, lead to a substitution effect causing the loss of market shares. Stopping previously legal trade and investment also poses a legal problem and can impact negatively on the trustworthiness of a country as an investment destination or reliable, ‘friendly’ trader.



Materials

Technologies

Sectors

Supply Risk
(sorted largest to smallest)


Very high | LREEs
HREEs


High | Magnesium
Niobium
Germanium
Borates
Scandium


Moderate | Strontium
Cobalt
PGMs
Natural graphite


Low | Indium
Vanadium
Lithium
Tungsten
Titanium
Gallium, Hafnium
Silicon metal


Very low | Manganese
Chromium
Zirconium
Tellurium
Nickel, Copper


Batteries 


Fuel cells 


Wind 


Traction Motors 


PV 

Robotics 

Drones 

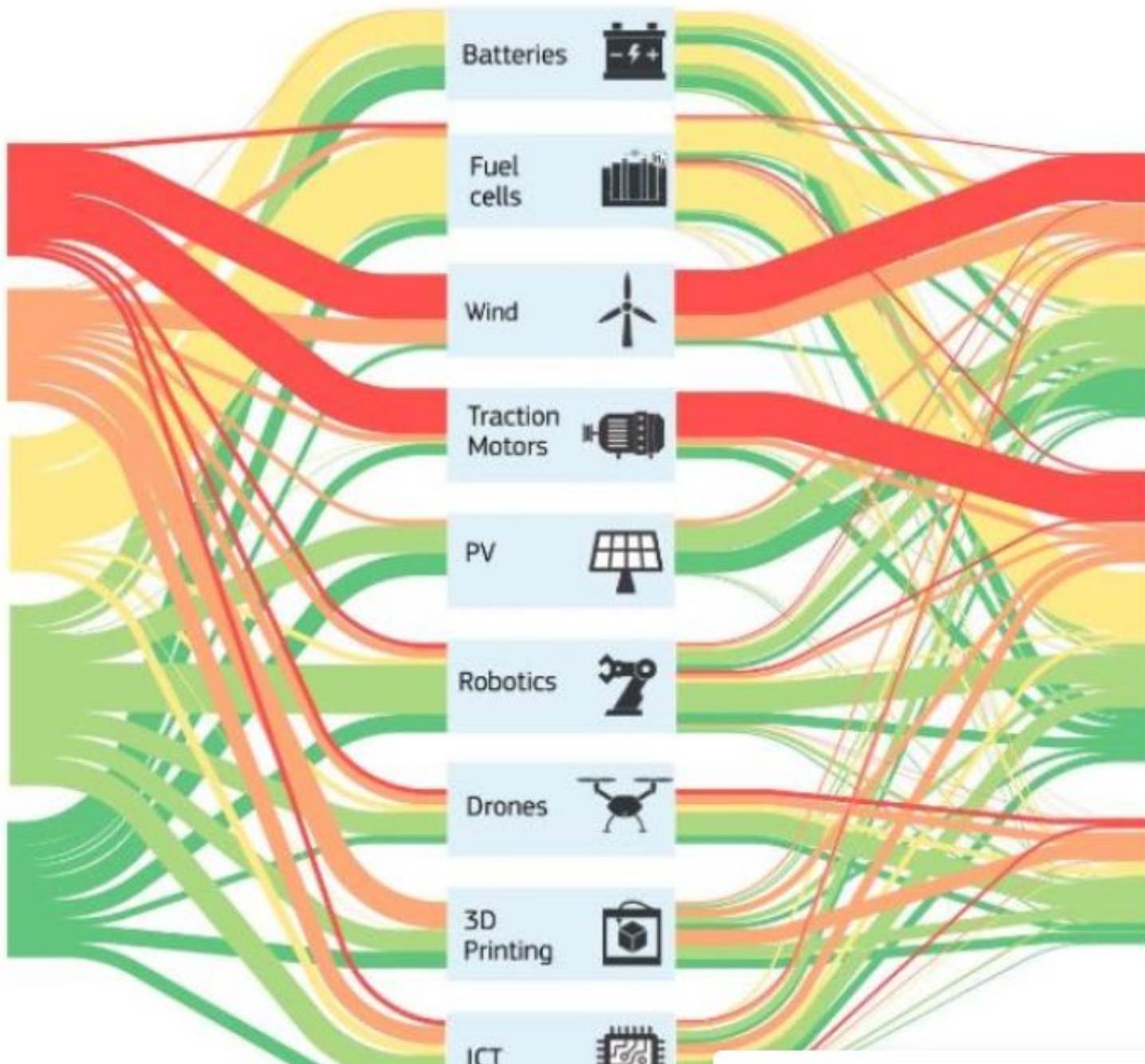
3D Printing 

ICT 

Renewables 

e-mobility 

Defence & Space 



Commission Recommendation on critical technology areas (EU Economic Security Strategy) for further risk assessment with Member States:

- “• **Enabling and transformative nature of the technology:** the technologies' potential and relevance for driving significant increases of performance and efficiency and/or radical changes for sectors, capabilities, etc.
- The risk of **civil and military fusion:** the technologies' relevance for both the civil and military sectors and its potential to advance both domains, as well as risk of uses of certain technologies to undermine peace and security.
- The risk the technology could be used in **violation of human rights:** the technologies' potential misuse in violation of human rights, including restricting fundamental freedoms.”

Four technological areas

1. **Advanced Semiconductors technologies** (microelectronics, photonics, high frequency chips, semiconductor manufacturing equipment);
2. **Artificial Intelligence technologies** (high performance computing, cloud and edge computing, data analytics, computer vision, language processing, object recognition);
3. **Quantum technologies** (quantum computing, quantum cryptography, quantum communications, quantum sensing and radar);
4. **Biotechnologies** (techniques of genetic modification, new genomic techniques, gene-drive, synthetic biology).



Industrial policy

- Government to direct industry or to incentivise industry -> different tools.
- Reorganisation of supply, production, value chains: Industry should have a natural interest to assure supplies, transport
Business continuity plans should have alternatives, short- and long term.
- Resilience, reconstruction of chains: under which conditions and to what extend can/should these costs incurred be borne by companies or by public sector





1 trillion
microchips were
manufactured
around the world in
2020

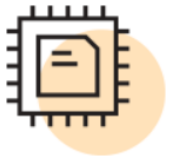
10%
EU's share of the
global microchips
market



Strengthen Europe's research and technology leadership towards smaller and faster chips



Put in place a framework to increase production capacity to 20% of the global market by 2030



Build and reinforce capacity to innovate in the design, manufacturing and packaging



Develop an in-depth understanding of the global semiconductor supply chains



Address the skills shortage, attract new talent and support the emergence of a skilled workforce

Chips Act 2023

- A framework for increasing the Union's resilience in the field of semiconductor technologies should be established,
- reinforcing the Union's semiconductor ecosystem by reducing dependencies,
- enhancing digital sovereignty, stimulating investment,
- strengthening the capabilities, security, adaptability and resilience of the Union's semiconductor supply chain, and
- increasing cooperation among the Member States, the Commission and international strategic partners.



Chips Act 2023 – chips diplomacy



- In accordance with international obligations and applicable procedural requirements the Union and Member States could engage, including **diplomatically**, with international strategic partners that have **advantages in the semiconductor industry**, with a view to seeking solutions to strengthen the **security of supply** and to address **future supply-chain disruptions of semiconductors**, such as those resulting from **third-country export restrictions**, and to identify the **availability of raw materials** and intermediate products.
- This may involve, where appropriate, coordination in relevant international fora, concluding **investment and trade agreements** or other diplomatic efforts in accordance with the applicable procedural requirements or engagement with relevant stakeholders.

Chips Act 2023 – chip diplomacy 2

- It is a clear objective of the Union to promote international cooperation and knowledge exchange on the basis of the **Union's interests, mutual benefits, international commitments, and, to the extent possible, reciprocity.**
- Nevertheless, the **infringement of intellectual property (IP) rights, the unauthorised disclosure of trade secrets, or the leakage of sensitive emerging technologies** in the semiconductor sector could compromise the interests of the security of the Union.
- Against this background, the Commission is exploring concrete proposals to strengthen the Union's **investment and export control frameworks**. In addition, the Union and the Member States should cooperate with strategic partners to strengthen the joint technological and industrial **leadership** in accordance with applicable procedural requirements



Lord Palmerstone

“We have no eternal allies, and we have no perpetual enemies.

Our interests are eternal and perpetual, and those interests it is our duty to follow.”

