

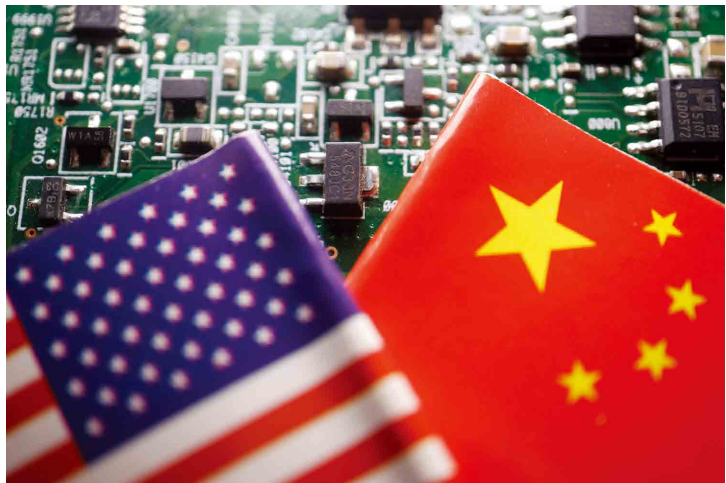
Chapter 3: The Increasingly Uncertain World Economy

Section 1: Economic Security under US-China Competition

Against the backdrop of US-China competition, countries are making concrete progress in economic security policy. Above all, countries are focused on promoting and protecting advanced technologies to gain strategic superiority, restructuring their supply chains and undertaking other efforts to make their economies secure. International cooperation in these efforts has grown, with concrete measures announced at the G7 Hiroshima Summit, the Japan-US-ROK Summit, and other venues. In addition, the emerging and developing countries of the so-called Global South have stepped up their presence in the midst of supply chain restructuring and other changes, increasing uncertainty about the future of the international economic order.

Competition for strategic superiority: struggles over advanced technologies

The US and China compete against each other militarily, economically and otherwise while also vying to strengthen their ties with emerging economies, with advanced technology remaining the frontier of US-China rivalry. The US-China competition in this arena is also a race to maintain or gain strategic superiority over the other. Since advanced semiconductors, artificial intelligence (AI), and quantum computing are seen as particularly key



(Photo: Reuters/Aflo)

areas that will determine future balances of power in the international system, numerous countries are committed to promoting and protecting these cutting-edge technologies. Notable progress was made in such national policies and in international cooperation during 2023.

In the race for strategic superiority, the US continues to step up its efforts to promote advanced technologies. For example, in May, the US Department of Defense released its “National Defense Science and Technology Strategy,” which emphasizes its commitment to key technology areas such as biotechnology, quantum science, next-generation wireless communications, and advanced materials. In addition, the 2022 CHIPS Act, which authorized a \$52.7 billion grant program, effectively launched initiatives to encourage the domestic production of advanced semiconductors.

Japan is also focusing on developing advanced technologies. In August, the Japanese government added 23 new advanced technology fields to the list of “specified critical technologies” indicated in the Economic Security Promotion Act. In addition to supporting Rapidus, a Japanese high-end semiconductor manufacturing company, the government took concrete steps to promote advanced semiconductors by assisting other makers of memory chips and related materials. Nevertheless, it became clear that Japan’s capabilities in cutting-edge scientific research have still not improved. While the presence of China and other emerging countries is increasing in terms of the number of academic articles published worldwide, Japan’s share is declining both quantitatively and qualitatively.

However, Japan did endeavor alongside its allies and partners to encourage international cooperation in advanced technologies. The Japan-US summit meeting in May called for cooperation in promoting and protecting critical technologies such as semiconductors, AI, biotechnology, and quantum computing. This was followed by the conclusion of a memorandum on educational cooperation between Japan and the US to strengthen human capital development. At the second meeting of the Japan-US Commerce and Industrial Partnership (JUCIP), further collaboration was agreed upon to formulate a common Japan-US roadmap for the development of next-generation semiconductors; cooperation in the fields of AI, biotechnology, and quantum technology was also announced. Furthermore, the joint statement of the second Ministerial Meeting of the Japan-US Economic Policy Consultative Committee (the Economic “2+2”) held in October confirmed the promotion of critical and emerging technologies. In parallel with these inter-government partnerships, the private sector also made solid progress in international cooperation on advanced technologies, such as the agreement among The University of Tokyo, the University of Chicago, IBM, and Google to collaborate in the field of quantum technology.

At the same time, measures to address technology leakage were fortified out of concern over the dramatically increased development speed of advanced technologies and the threat of their abuse. In February, the US government focused on enhancing the effectiveness of export controls by launching the “Disruptive Technology Strike Force,” tasked with toughening export control enforcement, fostering partnerships with the private sector, and leveraging international partnerships to coordinate law enforcement actions and disruption strategies. In October, the US government beefed up controls on semiconductor exports to China by updating the semiconductor export control measures announced in 2022 and introduced measures to close export control loopholes. Furthermore, the US government has embarked on onward foreign direct investment controls. It has been pointed out that the executive order addressing US investments signed by US President Joe Biden in August was aimed at curtailing technological innovations that would contribute to China’s military-civil fusion by restricting access to technological know-how and experts. Since the restrictions target only technologies and goods in semiconductors and microelectronics, AI, and quantum information technology, the measures are akin to a “small-yard high-fence” approach. However, the scope of the restrictions may be expanded in future.

The US government is extremely concerned about technology leakage through academic activities. In

June, the Pentagon released a list of Chinese and Russian institutions engaged in “problematic activities” aimed at gaining unauthorized access to sensitive US research and influencing faculty and students. There were also calls in the US Congress for reassessing science and technology cooperation with China and revising the US-China Science and Technology Cooperation Agreement (STA) that has been in place since 1979. Although it was ultimately decided to extend the STA provisionally for six months, the future of the STA remains unpredictable.

Japan has also been strengthening its measures to prevent technology leakage. As one measure to prevent the leakage of advanced technology, the government designated 25 fields, among them stealth technology and autonomous control technology, that are subject to the “patent non-disclosure system” outlined in the Economic Security Promotion Act. Discussions were conducted by a panel of experts on a security clearance system that would allow only qualified personnel to handle confidential information, and some progress was made toward introducing this system. In this regard, the arrest in June of a Chinese researcher affiliated with the National Research and Development Agency for leaking research data to a Chinese company did in fact draw much public attention from the perspective of economic security because the researcher had previously been employed at a Chinese university believed to have close ties to the Chinese People’s Liberation Army.

International cooperation on technology protection has also moved forward. It is noteworthy that a new international alignment of semiconductor export controls has essentially begun. In January, it was reported that the governments of Japan, the US, and the Netherlands had agreed to take joint steps on controlling semiconductor exports to China. Subsequently, the Japanese and Dutch governments implemented new semiconductor-related export controls without naming China (as mentioned above, the US also updated its existing semiconductor export controls on China). Following the August trilateral summit among the leaders of Japan, the US, and the ROK, it was announced that exchanges would take place among their export control enforcement agencies to share information and deepen cooperation.

It is noteworthy that these new frameworks were hammered out through new plurilateral/minilateral measures outside the existing multilateral export control regimes such as the Wassenaar Arrangement. Furthermore, the leakage of sensitive technologies through international joint research activities garnered attention. International cooperation in research security was pursued, as expressed in the G7 Hiroshima Leaders’ Communiqué, which addressed inappropriate transfers of critical and emerging technologies through research activities. However, the road ahead for international cooperation in technology protection will not necessarily be a smooth one. For example, although the G7, the US-EU Trade and Technology Council (TTC), and the EU Economic Security Strategy have admitted that measures pertaining to outward foreign direct investment could serve as a new tool, members differ on the specific content of such measures and their anticipated effectiveness.

In response to these efforts by Japan, the US and other countries to gain technological superiority, China is likewise making its utmost efforts to develop and promote advanced technologies. At the 14th

National People's Congress in March, Chinese President Xi Jinping stated that China should ultimately rely on scientific and technological innovation to open up new areas and new arenas in development and foster new growth drivers and new strengths in the face of fierce international competition. Indeed, China ranks first in some technological fields according to certain indicators.

It has become clearer than ever that the promotion of advanced technology in China will be led by the Communist Party. Structural reforms at the State Council have led to a reorganization of the Ministry of Science and Technology, and the Political Consultative Conference has appointed technology experts in such fields as semiconductors, robotics, lasers, and aerospace. In August, China released implementation guidelines as part of its China Standards 2035 strategy for accelerating new high-quality industries such as next-generation/quantum information technology. China is aiming to get ahead of the curve in these new industries. In addition, technological breakthroughs in advanced fields such as quantum information, carbon fiber, and brain-machine interfaces were declared to be demonstrations of China's excellence.

While advancing domestic efforts toward technological innovation, China also seeks to absorb foreign technology through supply chains linked to other countries. It still employs a mix of legal and illegal means, including industrial espionage and talent acquisition. In fact, ASML, a Dutch semiconductor equipment manufacturer, noted in its annual report that data related to proprietary technology had been stolen by a former Chinese employee. Such technology was also reportedly acquired using a patent panel.

Efforts to attract foreign investment have been stepped up. These include support for foreign investment in the establishment of research and development (R&D) centers. The guidelines for attracting foreign investment issued by the State Council in August incorporated such approaches as bolstering the protection of foreign investors' rights and interests by strictly enforcing intellectual property rights, offering financial support and tax incentives to foreign companies, and easing restrictions on data transfer. However, it is difficult to say that these efforts worked as successfully as planned. China's revised Counter-espionage Law that went into effect on July 1, as well as compulsory investigations taken against foreign companies by authorities and the detention and arrest of employees of foreign companies, negatively affected foreign investment; the volume of FDI to China in 2023 was down compared to the previous year.

Making economies secure

As US-China competition grew fiercer, making economies secure became more important for all countries out of the need not only to maximize profits through economic activities, but also to secure the foundations on which economic activities themselves are based. As a result, concrete measures were considered to ensure the security of supply chains for critical goods and minerals and to prepare for supply chain disruptions. While economic efficiency was the driving force behind supply chain designs in the past, it is now receding behind the desire for stability and sustainability. Instead of economic rationality being the top priority in corporate strategies, security, stability, and sustainability have become the key agenda items. To make supply chains and value chains more robust, new relationships with

trusted partners have been built by developing new supplies and markets. Mexico replacing China as the US's top trading partner was also a result of these trends.

Japan, too, pursued new relationships with other partners to ensure the security of supply chains for critical materials and minerals. Cooperation was sought with countries such as Canada, Australia, the Democratic Republic of the Congo, and Zambia to establish stable supply chains for critical minerals. The aim was to reduce overdependence on China, a major producer of rare earths and other critical minerals.

International attempts were also made to prepare against disruptions to supply chains for critical goods and minerals. In February, it was reported that Chip4, an international semiconductor partnership comprising Japan, the US, the ROK, and Taiwan, discussed an early warning system to ensure stable semiconductor supply chains. At the Japan-US-ROK summit meeting in August, it was agreed to launch pilot supply chain early-warning systems. In addition, the Indo-Pacific Economic Framework (IPEF) made progress in efforts to make supply chains more robust. These frameworks are new plurilateral/minilateral frameworks created outside of existing international institutions.

International alignment and institutionalization against economic coercion are also seeing progress. At their Hiroshima Summit, the G7 released the G7 Leaders' Statement on Economic Resilience and Economic Security, the first of its kind, and announced that its members had agreed to launch a Coordination Platform on Economic Coercion. Other measures against economic coercion were pursued outside the G7 framework. In June, the "Joint Declaration against Trade-Related Economic Coercion and Non-Market Policies and Practices" was issued by Japan and the Five Eyes countries (the US, the UK, Australia, Canada, and New Zealand) to address economic coercion. The EU has been the most progressive in this area, with an EU ministerial meeting in October approving new rules to counter economic coercion.

However, a complete break with China in all aspects of industrial and economic activity is not realistic and is not something being sought. For example, in March, European Commission President Ursula von der Leyen called for a focus on de-risking (continuing relations while reducing risks) rather than decoupling (breaking off relations) in EU-China dealings, acknowledging that some products and services can be traded without risk. The main point is to protect national security while maintaining trade and investment in a way that does not pose a threat to national security. This concept of de-risking became the basis for Europe's approach to China, and was later used in the G7 Hiroshima Leaders' Communiqué and other initiatives.

On the other hand, it seems that Chinese authorities regard the West's supply chain restructuring and other such economic security endeavors as attempts to isolate China from the rest of the world. Therefore, while enjoying the economic and technological benefits of international supply chains, Chinese authorities are now placing more emphasis on increasing self-sufficiency by expanding domestic production capacity and on striving to build an ecosystem that is less susceptible to foreign influence.

China is focusing on R&D of semiconductor manufacturing equipment because it cannot procure advanced semiconductor manufacturing equipment due to export control measures imposed by countries such as Japan, the US, and the Netherlands. In September, China announced the launch of a new \$40 billion government investment fund for the semiconductor industry, its aims believed to be increasing the domestic semiconductor industry's self-sufficiency and reducing its dependence on foreign countries. In line with these government policies, Chinese semiconductor manufacturing companies are trying to break free of their dependence on foreign-made manufacturing equipment and switch to domestically-produced equipment by cooperating more closely with domestic semiconductor manufacturing equipment makers.

Faced with setbacks in introducing semiconductor miniaturization technology, Chinese corporations are concentrating on manufacturing middle-end and low-end “legacy” semiconductors. China's adoption of subsidies and other industrial policies in favor of legacy semiconductors is raising economic security concerns in the US and elsewhere. In addition, China is promoting technologies other than miniaturization by, for instance, starting up a new funding program for chiplet-related research projects with a focus on the back-end processes of semiconductor manufacturing. The purpose of these measures is to increase the self-sufficiency of the domestic semiconductor industry and reduce its dependence on foreign suppliers, thereby creating an ecosystem less susceptible to foreign export controls and other measures.

In the course of striving to build this ecosystem, Chinese authorities have taken actions that could be seen as economic coercion or retaliation to influence political decisions. In May, for example, operators of domestic critical infrastructure were banned from using Micron products from the US for cybersecurity reasons. It was announced in July and October that gallium- and germanium-related items as well as some graphite-related items would be subject to export controls. In addition, reviews of mergers and acquisitions (M&A) under the Anti-Monopoly Law appear to have been intentionally delayed. In fact, in August, Intel withdrew its offer to acquire an Israeli semiconductor company because it could not get approval from Chinese authorities by the deadline. Some argue that these actions have been taken in retaliation for a series of US-led export control measures against China.

It is certainly difficult to assess the effectiveness of those measures taken by Chinese authorities that appear to be economic coercion or retaliation, since the purposes of their actions and operational policies are often difficult to understand for outside observers. However, these measures have not always born fruit. For example, in August, the Chinese government lifted import tariffs on Australian barley that had been imposed in 2020, and thereafter gradually removed other restrictions on imports of Australian products. This may have had limited impact, however, because Australian barley producers had already responded by developing new markets and switching production to wheat. This example can serve as a lesson on reacting to future coercive actions.

Growing presence of the Global South

As supply chains and other aspects of the international economy are being restructured, the presence of

countries other than the major powers has also increased. In particular, the economies of the Global South are growing in scale, and their share of the international economy in terms of nominal GDP is expected to continue expanding. Furthermore, countries rich in resources rather than military or economic power have become ever more important in the international economy, thanks to factors such as de-risking, digital transformation (DX) and green transformation (GX). With securing



Lithium industry in Chile (April 2023, Photo: AP/Aflo)

stable supplies of critical minerals and rare metals becoming a key strategic issue for countries, alignment with the Global South became an important agenda from an economic security perspective.

However, some in the Global South have made their own interests a top priority and sought to secure and enhance their strategic autonomy rather than join a particular group that supports certain principles or norms reflected in the international order. For example, countries such as Argentina, Brazil, Chile, and Indonesia are reported to be more welcoming of investment from China than the US in their battery factories. In addition, some economies see international supply chain restructuring as an opportunity. The importance of ASEAN countries, Central and Eastern European countries, India, and Mexico as manufacturing bases in the global economy will undoubtedly grow. India, for instance, will try to take advantage of international supply chain restructuring to develop its own industries through a Japan-India industrial co-creation initiative and the US-India Strategic and Commercial Dialogue. Brazil is also looking to seize opportunities for new industry development by signing a semiconductor agreement with China.

With the security of critical mineral supply chains being recognized as an economic security issue, some resource-rich countries (many of them in the Global South) are strengthening control and management of their own resources and seeking to secure strategic autonomy. For example, amid rising demand for lithium in electric vehicle batteries and other products, Chile, the world's second-largest lithium producer, formulated a "National Lithium Strategy" in June and decided to turn some new lithium mining projects into joint ventures with state-owned companies. In response, an action plan to ensure reliable supplies of critical minerals was formulated at the G7 Ministers' Meeting on Climate, Energy, and Environment in April, and concerns were expressed at the G7 Trade Ministers' Meeting in October about export controls on critical minerals. The presence of resource-rich powers, including those in the Global South, is thus growing, and uncertainty about the future of the global economy is

mounting. How to achieve greater cooperation with countries rich in critical minerals and other resources will become an increasingly important policy issue.

Prospects and recommendations

Countries have made tangible progress in their economic security policies in the midst of US-China competition. Nevertheless, many challenges remain, firstly those stemming from efforts to gain strategic superiority. As countries struggle to manufacture critical goods such as advanced semiconductors, attract cutting-edge companies, and engage in R&D of advanced technologies, subsidy competitions appear to be emerging in those industrial and technological sectors that their governments are pushing. In general, subsidy competitions can create a distorted ecosystem by inducing redundant and excessive investments in certain areas, lead to inefficient corporate management, and generate market distortions. Additionally, it has long been noted that Japan's scientific research capabilities have been declining, and this decline did not stop in 2023. It also appears that international coordination of technology protection measures has not always gone smoothly. It is unclear how much international support the US government's measures on outward foreign direct investment will receive in the future, and there are differing views among countries on research security designed to prevent technology leakage through academic activities. Therefore, it will be essential that Japan seek closer cooperation with allies and partners to achieve strategic superiority. For instance, it would be useful to coordinate subsidy schemes and technology protection measures (export controls, investment restrictions, and research security) not only through existing international institutions but also through new international frameworks. To reverse the declining trend in the country's scientific research capabilities, Japan will need to expand and deepen human capital development in areas such as STEM education, improve research environments, and pursue international cooperation on human capital development.

Efforts to make economies more secure, with supply chain restructuring being a typical approach, still face challenges. It is no easy task to identify chokepoints in international supply chains built around economic efficiency and to develop alternatives (supplies, markets, production bases, goods, and technologies) from the perspectives of security, stability, and sustainability. De-risking and supply chain restructuring that reflect foreign policy and national security logic could reduce predictability in economic activity and even cause friction with existing international trade rules. Accordingly, concrete steps must be taken to mitigate economic vulnerabilities through international cooperation to ensure economic security. The first of these should be launching the platform for coordination against economic coercion announced by the G7 and putting into pilot operation the supply chain early warning system agreed to by Japan, the US, and the ROK. New measures might include building international consensus, institutionalizing and forming norms for processes to identify coercion, resorting to counter-tariff measures, restricting public procurement, and compensating for losses. Each of these measures would also need to be coordinated with existing trade regimes.

Numerous issues surround cooperation with the countries of the Global South, which are emerging as important actors in economic security. While the countries tagged together as the Global South may share some interests, they differ in policy stances and preferences. Therefore, it may be necessary to work with parties who do not necessarily support certain interests or values. Moreover, when there are many potential partners for such alignment, it is necessary to play a game of coalition building that allows for flexibility in recombining alignment partners. The nature of cooperation between parties would not be determined solely by the logic of great power competition; instead, alignment partners could be flexibly changed depending on conditions. In a world where US-China competition and multipolar global politics coexist, flexible cooperation with powers that do not necessarily share certain interests or values should be considered a viable option. For this reason, policies must be formulated from the view of economic security challenges and prospects, and corporate strategy priorities reviewed. It will be important to pursue tailor-made approaches with each partner. Where such attempts are not covered under existing international institutions, it may be necessary to establish new mechanisms and/or frameworks. ■

Section 2: The Economic Impacts of the War in Ukraine and Sanctions against Russia

Since the outbreak of the war in Ukraine, the G7 and other Western nations have continued to impose large-scale economic sanctions against Russia. In 2023, efforts were made to boost the effectiveness of these sanctions by strengthening export controls and engaging with countries that had not previously participated in these sanctions. While trade transactions between Russia and the countries sanctioning Russia have significantly decreased, China-Russia and India-Russia dependence has deepened through greater trade in crude oil and other commodities, indicating a shift in the flow of goods trade centered on Russia. The G7 nations and other sanctioning countries have maintained unity in their sanctions against Russia thus far, but the Hamas-Israel conflict that started in October is a disruptive factor that could undermine the Western countries' coordination if the conflict leads to events such as a surge in the price of Middle Eastern crude oil. In any case, the hurdles to further ratcheting up sanctions are high, and ongoing efforts are necessary to enhance the effectiveness of sanctions. Additionally, attention must be given to the potential side effects of sanctions, such as the impact of Russia's withdrawal from the Black Sea Grain Initiative on food supplies in developing countries and the growing dependency between China and Russia.

Trends in sanctions against Russia

As Russia's aggression against Ukraine continues, Western countries, centered on the G7, are working to broaden and amplify the effectiveness of export controls and other sanctions against Russia. The US added to the sanction targets a list of entities located in Russia, Belarus, China, Taiwan, Turkey, Iran, India, Spain and elsewhere that were deemed to be contributing to Russia's military and defense industries. In addition to expanding the areas targeted



Ukrainian President Volodymyr Zelenskyy joins G7 leaders at a working session on the final day of the G7 Summit in Hiroshima, Japan. (May 2023, Photo: Pool/AP/Aflo)

by the sanctions against Russia, efforts were also pursued to increase their effectiveness. For example, the US published guidelines for financial institutions on export control circumvention activities, and the G7 announced a new enforcement mechanism for export activities designed to circumvent sanctions against Russia. The Five Eyes, consisting of the US, the UK, Canada, Australia, and New Zealand, formally agreed to cooperate in enforcing export controls against Russia, including sharing information

on illegal procurement activities and other export control violations. The US is investigating whether China is providing goods and technology that could support the war in Ukraine and has added the relevant Chinese companies and organizations to its export control list to strengthen enforcement. In this way, steps were taken to improve the effectiveness of sanctions and thereby reduce Russia's ability to continue its war.

Initiatives were also taken to eliminate loopholes in the sanctions in view of sanctions-evading behavior such as the use of third parties for circumvention. As part of these efforts, complying countries reached out to countries not yet participating in the sanctions. For example, US officials visited Turkey and the UAE in February to seek their cooperation in implementing sanctions against Russia. In April, US, UK and EU export control officials visited Kazakhstan to provide technical assistance and to share information with the Kazakh government and private sector to address the problem of sanctions against Russia. In addition, proactive measures were taken to encourage more countries to conform to the sanctions. The US government imposed secondary sanctions against foreign entities engaged in sanctions evasion, and the EU introduced export control measures against actors evading sanctions in its 11th round of sanctions against Russia.

Impact of the war in Ukraine and sanctions against Russia on various regions

More than a year after the start of the massive economic sanctions imposed by the Western countries in response to Russia's invasion of Ukraine, the impacts on Russia's domestic economy have become noticeable. According to the IMF, Russia's GDP growth fell to -2.0% year-on-year in 2022, partly due to the sanctions, but is expected to rise to 2.2% in 2023. A breakdown of this figure shows this growth is driven by an increase in government spending, including war expenditures and the expansion of military services such as weapons manufacturing. Given the sluggish growth in private consumption, investment, and exports, it is reasonable to conclude that economic sanctions are inflicting a certain level of damage on the Russian economy. The Russian ruble had been recovering after experiencing a sharp decline immediately after the invasion in February 2022 but, due in part to a reduction in the country's current account surplus, the currency exhibited a downward trend again in 2023. The Central Bank of Russia raised its key policy rate from 8% to 12% in August, but this has yet to stem the depreciation of the ruble. Alongside the rise in import prices, domestic inflation has surged to levels exceeding 4%. Furthermore, supply is constrained by a shortage of goods and labor, while demand is rising due to expansionary fiscal spending, which is also contributing to higher prices. Although the federal budget deficit has ballooned since the start of the war in Ukraine, Russia appears to have ample fiscal reserves for the foreseeable future. However, it is crucial to monitor how long the reliance on wartime fiscal expansion can be sustained. In addition, the potential for future growth over the medium to long term will likely be lost due to wartime casualties, inefficient investment allocation, and detachment from the global economy.

On the other hand, a survey by the Levada Center, a public opinion survey organization, shows that

support for President Vladimir Putin within Russia remained in the 80% range throughout 2023, and support for the government stayed in the upper 60% range. At the same time, as discussed in Chapter 2, Section 1, the power base and support for Putin's government are being solidified through arrests of dissidents and individuals who criticize President Putin and his administration, as well as through the imposition of restrictive measures on anti-government organizations.

As noted in our previous Report, Russia has been facing economic sanctions since the annexation of Crimea in 2014. Regardless of the intensification of sanctions, there seems to be a certain degree of "sanctions habituation" among the population as they adapt to the pressure of Western sanctions and the impact on social life. With the short-term positive signs in the domestic economy due to the expansion of government spending mentioned earlier and with the adverse effects on citizens' lives being blamed on Western countries, there are currently no noticeable signs of significant turmoil or public condemnation of the government.

The economic sanctions have also had a noticeable impact on Russia's foreign trade. Since the second quarter of 2022, after the sanctions took effect, data show that Russia's trade with the US is down 85% year-on-year for exports and 69% for imports, trade with the EU is down 53% for exports and 8% for imports, and trade with Japan is down 51% for exports and 9% for imports (source: IMF Direction of Trade Statistics). The decline continued in 2023. The EU has been trying to wean itself off Russian energy, reducing the share of natural gas imports from Russia to less than half during the first half of 2023 and cutting crude oil imports by 90%. Meanwhile, Russia is shifting its trade to partners such as China, India, Turkey, and the Central Asian countries that are not participating in sanctions. This has become a loophole in the sanctions, as semiconductors embedded in consumer electronics imported from Kazakhstan, a former constituent of the Soviet Union, are being converted for use in weapons. Among other circumventions have been re-exports of Russian crude oil labelled as oil produced in the United Arab Emirates (UAE) via the UAE, and crude oil shipments from Russia aboard ships of Hong Kong registry.

As for the impact on the global economy, rising energy prices have contributed to inflation, primarily through higher utility costs. According to the Energy White Paper 2023, electricity prices in January 2023 rose 30% in Japan, 50% in the EU, and tripled in Italy. Energy prices settled down in 2023, though, mainly due to the global economic slowdown. Natural gas soared to \$70/million BTU in August 2022 in Europe but dropped to \$11/million BTU in the same month of 2023. WTI crude oil prices climbed to \$114/bbl in June 2022, then fell to \$70/bbl in the same month of 2023 before rising moderately. As for grain prices, prices for wheat and corn stabilized in 2023, mirroring energy prices. However, when Russia announced in July that it would suspend implementation of the Black Sea Grain Initiative, grain prices temporarily rose due to concerns that this would threaten global food security. The instability in food prices spilled over into India, which in July imposed restrictions on rice exports to ensure stable domestic food prices. This led to an increase in rice export prices, which in turn affected African and other countries that are

highly dependent on rice imports from India.

The Black Sea Grain Initiative concluded among the UN, Turkey, Russia, and Ukraine on July 22, 2022 was repeatedly extended, but on July 17, 2023 Russia effectively suspended it by not agreeing to an extension. Russia had been expressing dissatisfaction with Western sanctions against Russian grain and fertilizers since the beginning of 2023 and had frequently indicated that it would withdraw from the agreement. The United Nations, Turkey, and South Africa acted as mediators, and the Russian side was initially inclined to



Saint-Kitts-and-Nevis-flagged bulker TK Majestic, carrying grain under the UN's Black Sea Grain Initiative, waits in the southern anchorage of the Bosphorus in Istanbul, Turkey. (July 2023, Photo: Reuters/Aflo)

extend the agreement on condition that sanctions were eased, but the attack on the Crimean Bridge on July 17 led Russia to declare the agreement suspended. On July 18, Russia attacked the port facilities in Odessa, Ukraine, in retaliation for the attack on the Crimean Bridge, and announced that it would not guarantee innocent passage for civilian vessels in the Black Sea. This created a critical situation for grain shipments to Central Asia and Africa, which were in danger of severe food shortages, and for other humanitarian aid that was the purpose of this agreement. The US, European countries, and Ukraine are considering grain export routes other than the Black Sea that do not pass through Russia, but there is an urgent need to establish safe food transport routes.

In Europe, the impacts of sanctions against Russia are subsiding, particularly in the energy sector. Electricity prices have fallen relative to 2022 levels due to energy stockpiling after the winter of 2022 and diversification, including increased use of fossil fuels. At the July 2023 NATO summit, the G7 decided on a joint statement reiterating their commitment to long-term support for Ukraine. The solidarity among Western countries is firm, and no one has yet dropped out of the original group of countries imposing sanctions. On the other hand, the hurdles to new and stronger sanctions are high. When the EU embargo on Ukrainian grain imports expired in September, Poland, Hungary, and Slovakia reacted sharply, citing the adverse impacts of importing cheap grain from Ukraine in demanding that the embargo remain in place. In addition, the Hamas-Israel conflict that began in October sent shockwaves throughout the international community and had the effect of lowering the policy priority of support for Ukraine in Western nations.

China's support for Russia, internationally isolated by its war in Ukraine, has been remarkable. Since the imposition of sanctions against Russia, Sino-Russian economic ties have grown closer, with China

becoming Russia's most important economic partner: Sino-Russian trade in 2022 was \$185 billion, up 30% from the previous year, and is expected to increase by about 30% to over \$230 billion in 2023. The growth in China's exports of construction machinery and freight vehicles has been quite notable, while exports of integrated circuits have more than doubled. Chinese manufacturers' share of the Russian automobile market is expected to grow rapidly and exceed 50% of new car sales in 2023, as Western



Russian President Vladimir Putin and Chinese President Xi Jinping shake hands during a meeting at the Belt and Road Forum in Beijing, China. (October 2023, Photo: Pool/Reuters/Aflo)

manufacturers withdraw and exports decline. The supply of auto parts from China for local production by local manufacturers and others is also increasing rapidly. On the financial side, the exclusion of Russia from the SWIFT international payments network and the freezing of foreign exchange reserves held by the Russian central bank have led to an increased use of yuan in trade settlements between China and Russia and in transactions between Russia and third countries that are expanding RMB settlements with China. The situation is such that Russia, cut off from world markets, is in effect rapidly becoming more dependent on the Chinese economy through trade, investment and finance. At the China-Russia summit meeting in March, a joint statement on Sino-Russian economic cooperation through 2030 was issued. In the statement, the two countries proposed cooperation in eight areas, among them being trade and investment, logistics, finance (including the increased use of national currencies), energy, and technology cooperation. The joint statement also indicated directions for industrial cooperation across a wide range of fields, including automobiles, aviation, nonferrous metals, space, biotechnology, and pharmaceuticals. In addition, plans are underway to strengthen connectivity by improving transportation infrastructure and constructing a new Power of Siberia 2 natural gas pipeline via Mongolia to complement the Power of Siberia natural gas pipeline that began operations in 2022.

India, too, is expanding its economic ties with Russia. With Russian crude oil having become much cheaper than WTI as economic sanctions cut off numerous sales channels, the share of Russian crude oil in India's imports has increased from less than 2% in January 2022 to 30% since March 2023. Furthermore, ministers from both countries announced in April that they were discussing a free trade agreement (FTA). In its pursuit of omnidirectional diplomacy, India has strengthened its ties with the West through the Quad and other means while going beyond a "neutral" stance in its relations with Russia, a traditional friend of India. This is driven by significant concerns arising from the growing proximity between China and Russia, viewed through the lens of India's security considerations vis-à-vis

China. While facing restrictions on procuring items that could contribute to military applications and on enhancing industrial infrastructure due to economic sanctions, Russia is said to have checked with India on the possibility of supplying over 500 essential items for maintaining key industries. Additionally, there are reports that Moscow is repurchasing weapons previously exported from Russia to India. From a macroeconomic perspective, however, India-Russia economic relations are limited in nature, and there have been no notable expansionary developments other than energy-related transactions. The immediate focus of attention is likely to be India's increasing emphasis on cooperation with the US in the military sector, including weapons development.

Prospects and recommendations

To reduce Russia's ability to continue the war in Ukraine, it will first be necessary to increase the effectiveness of existing sanctions against Russia's military, defense industries, and intelligence services. Accordingly, further coordination among diplomatic, trade, financial, and other sanctions authorities in sanctioning countries will be vital to enhance the ability of these countries to implement sanctions against Russia. Specifically, such coordination could identify the goods and technologies that the Russian military and others seek to procure, the means and routes used to circumvent sanctions, and the actors involved in sanctions evasion, and then share this information among sanctioning countries. To ensure compliance by the private sector in sanctioning countries, technical assistance through the dispatch of sanctions officers among sanctioning countries could be considered.

Obtaining cooperation from countries not participating in the sanctions against Russia to close loopholes such as import diversion or money laundering is also essential. In doing so, the specific diplomatic and economic circumstances of countries that do not subscribe to the sanctions must be considered. It would be useful to create a structure in which non-participating countries are not used as loopholes and in which it is to their benefit, or at least not to their detriment, not to be used as loopholes. Providing information and technical assistance to non-participating countries to prevent them from being unintentionally used as loopholes will also remain important.

Due to the authoritarian system and habituation to sanctions in Russia, economic sanctions have not had the intended effect of increasing public dissatisfaction with the damage done to the domestic economy and causing the Putin administration to change its policy regarding the invasion of Ukraine. Nevertheless, the long-term depreciation of the ruble and the inflation that affects daily purchasing behavior will be a major shock for many Russians who experienced the economic and social turmoil in the 1990s that followed the collapse of the Soviet Union. While economic sanctions are not expected to immediately lead to a ceasefire, it is crucial to assess the internal situation in Russia and devise strategies for leveraging economic sanctions in ceasefire negotiations and similar efforts. It would be beneficial to promptly establish consensus among relevant countries, including G7 members, on whether Russia's frozen assets abroad can be utilized for supporting the reconstruction of Ukraine, consider the legal

aspects, and proceed with implementation.

Even as economic sanctions inflict damage on the Russian economy, a situation has emerged where ties between China and Russia as well as between India and Russia have been strengthened in response. Particularly noteworthy is the increasing economic dependence of Russia on China through trade, investment, and financial channels. In connection with the economic sanctions, it is crucial to consider how to handle post-Ukraine war relations with Russia, bearing in mind how lifting the economic sanctions against Russia could be used as leverage to prevent further solidification of Russia's dependence on China.

Furthermore, to prevent India from further aligning with Russia, it is essential to strengthen security and economic cooperation between the US and India, Japan and India, and within the Quad, alleviating India's security concerns arising from the growing proximity between China and Russia. Additionally, fostering closer collaboration between India and Western countries through platforms such as the G7 is important. During this communication process, candid opinions need to be conveyed to the Indian side, such as sending the message that signing an India-Russia Free Trade Agreement would be premature given the current international situation.

Lastly, since the outbreak of the Ukraine war, issues related to food security have been exacerbated once again due to Russia's withdrawal from the Black Sea Initiative. It is crucial to work towards Russia's return to the Black Sea Initiative by collaborating with the emerging and developing countries often referred to as the Global South. Additionally, providing food assistance to countries in the Middle East and Africa, which are particularly vulnerable to the soaring food and energy prices, is indispensable. Moreover, there is a need to enhance domestic productivity in numerous countries by supporting their agricultural sectors, improving their logistics infrastructure, and encouraging them to diversify their supply sources. Cooperation on global food security should be advanced by strengthening collaboration by the United Nations, development finance institutions, the G7/G20, and other multi-layered fora with the Global South. ■