US/ASIA/EU: Trilateral chip deal another step towards decoupling

- The trilateral chip export ban agreed last week would represent a win for the US but the devil will inevitably be in the technical details, which may not be known for some time.
- The Dutch government broadly favors a deal, though US and EU policymakers' increasingly broad conception of national security threatens the Netherlands' export-oriented economy.
- Japan faces both economic and geopolitical challenges in implementing any export ban but is willing to do so to deepen long-term security ties with the US.

The slate of export controls that the US Commerce Department announced on 7 October was a landmark escalation of Washington's effort to contain China's technological development, going far beyond earlier controls to include tool components and even human capital, as well as advanced semiconductor chips and the finished tools used to fabricate them.

But the decision to press ahead with these policies unilaterally was also a risky gamble. US officials apparently wagered that by demonstrating how seriously they regard the threat from China's chip industry, paired with a willingness to impose economic losses on US chip companies, Washington could prod reluctant allies to eventually follow suit.

Fab three

The extent to which this wager has paid off remains unclear, given the lack of detail about the trilateral agreement struck last week. The Hague will reportedly block ASML from exporting "at least some" deep ultraviolet (DUV) lithography machines to China. DUV machines are less advanced than the extreme ultraviolet (EUV) machines whose sale to China has already been restricted for several years. Dutch officials were skeptical of the national security rationale for banning exports of DUV technology, which is roughly 25 years old and already widely used in Chinese chip fabs, but Washington argued that DUV can also be used to produce relatively advanced chips.

The non-public elements of the deal will likely include commitments by Dutch and Japanese regulators to forbid sales to specific end-users and/or specific factories that produce chips beyond certain technical thresholds, perhaps including China's leading chipmaker SMIC. It remains unclear whether The Hague and Tokyo have agreed to replicate US restrictions on domestic persons working for advanced Chinese chip factories, and it is possible that these and other specifics still remain to be settled.

Lurking in the background of the negotiations was an implicit threat that if allies did not act voluntarily, Washington could achieve a similar outcome unilaterally by leveraging the reliance of European, Japanese, and South Korean chip equipment companies on US-origin technology by applying the Foreign Direct Product Rule. ASML, for example, relies on many US inputs for its lithography machines. The 7 October action already applied that rule to a degree, but space remains for Washington to apply the rule more broadly.

Chinese authorities are unlikely to retaliate directly. Through multiple rounds of escalating tech restrictions, Beijing has largely refrained from scapegoating foreign tech firms in response. This strategic forbearance is based on a calculation that alienating foreign businesses would only exacerbate the decoupling trend and weaken those firms' incentives to push back against pro-decoupling policies by their home governments. Instead, Beijing will remain focused on the long-term project of increasing its own self-sufficiency in semiconductors.

Hague headache

Passage of Dutch legislation to implement any deal might take time, despite broad political support. Within Prime Minister Mark Rutte's four-party coalition, concerns over China are stronger with liberals, while US ties are a priority for center-right members. The looming threat to its access to the US market will have been a powerful factor in one of Europe's most open, competitive, and export-dependent economies.

For the traditional Dutch economic model, US policy poses multiple risks, with recent interventions focused on national security and the green transformation. In the EU, France and Germany have also put forward major national support packages, while Brussels and many southern capitals are calling for further EU public investment. The Dutch are among the member-states that oppose that idea, but the risk for The Hague is that, rather than rejecting further market intervention in principle, Germany is merely playing for time with current calls to repurpose remaining Covid-19 recovery money first.

Towards indispensability

For Japan, any export ban has significant economic and geopolitical implications. Japanese firms are less involved in supply chains for the most advanced semiconductors, but their lower-end technologies are important in the production of less advanced chips. China is a moderately large producer of the latter and accounts for a significant share of sales for firms like Tokyo Electron and Nikon. And whereas the global economy's voracious demand for cutting-edge chips means that ASML would have little trouble finding alternative buyers for the 15% or so of their equipment sales that currently go to China, it is less clear that Japanese firms could easily do the same.

Geopolitically, Japan is highly sensitive to the optics around any deal, given the danger of retaliation from Beijing. Sino-Japanese relations have only recently been reset following the leaders' summit in Bangkok in November, the first such meeting in about three years. Prime Minister Fumio Kishida speaks of achieving a "constructive and stable" relationship, and influential business lobby Keidanren favors better economic ties. At the same time, Japan is significantly strengthening its defense posture in response to a deteriorating regional environment, and its new National Security Strategy labels China its "greatest strategic challenge."

But Tokyo also senses a window of geopolitical opportunity during the Biden era to copper-fasten its own security by making itself indispensable to Washington, both now and under any future administration that may tilt economic and security policy towards narrow nationalism. If the new export controls are finalized in the coming months, the government would have until mid-June to pass any legislation required to implement them unless it extended the current ordinary Diet session; the next opportunity to pass a bill would not arise until the fall Diet session beginning in October.

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