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CHINA MACRO GROUP

RISKFUL THINKING

Navigating the Politics of Economic Security

European Union Chamber of Commerce in China

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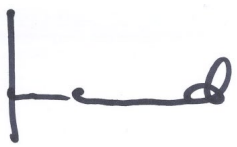
PRESIDENT'S FOREWORD

'De-risking' emerged as a new buzzword following Ursula von der Leyen's landmark March 2023 speech, in which she outlined the EU's new approach to mitigating a growing number of risks to its economy. One year on, the phrase continues to be misunderstood. Perhaps most worryingly, the current discourse surrounding EU de-risking, as well as the other forms of risk management being adopted by China and the US, has evolved into something of a blame game.

To shed more light on this topic, the Chamber is pleased to have partnered with China Macro Group (CMG) for this report, which details the respective approaches to risk management and strengthening economic security currently being developed by the EU, China and the US. It also details some of the impacts that related policies are having on European Chamber members, as well as some of the steps they are taking to shore up their operations.

This report comes at a time when the global business environment is becoming increasingly politicised, and companies are having to make some very tough decisions about how, or in some cases if, they can continue to engage with the Chinese market. Our hope is that this paper contributes positively to the ongoing discussion on 'de-risking', paving the way for the development of a common language on risk management. Ultimately, while all global actors have a sovereign right to ensure the security of their respective economies, the European Chamber believes that this should be done in a way that is minimally disruptive to business to ensure that the benefits of global trade and investment can continue to the greatest extent possible.

I wish to express my immense gratitude to the European Chamber member companies who agreed to be interviewed for this report. My sincere thanks also go to Luke Patey of the Danish Institute for International Studies, Alicia Garcia Herrero of Bruegel, and to officials from the European Commission's Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW) for their invaluable input.



Jens Eskelund
President
European Union Chamber of Commerce in China

EXECUTIVE SUMMARY

The European Union (EU), China and the United States (US) have all been engaged in varying degrees of risk management and efforts to strengthen economic security for several years,[1&2] however, it would be misleading to use 'de-risking' as a catch-all term to describe their respective approaches. While sharing some common roots, the measures being adopted, the desired outcomes and the length of time each actor has been engaged in such activities, are quite distinct.

First mentioned by German Chancellor Olaf Scholz in November 2022, 'de-risking' did not gain traction in political discourse until March 2023,[3] when it was referred to in a speech delivered by Ursula von der Leyen in which she outlined the EU's new approach to mitigating a growing number of risks to its economy, as well as its evolving relationship with China.[4] The Commission President made clear that while it is "neither viable – nor in Europe's interest" to decouple from China, it is seen as necessary to "rebalance" the relationship.[5]

The understanding that threats have become more prevalent to both the EU's overall economic security and its companies overseas has been embedded in European policy thinking for some time.[6&7] However, the perceived level of risk to the EU increased significantly following two black swan events, which catalysed the European Commission's approach to managing risk.

First, the COVID-19 pandemic, and the ensuing mobility restrictions, laid bare several critical vulnerabilities. Challenges to Europe's food security and the sudden inability to access essential medical supplies—including pharmaceuticals, personal protective equipment, testing kits and other healthcare equipment—due to supply chain instabilities,[8,9&10] brought home the extent to which the EU is overdependent on certain third countries, and raised doubts over the EU's long-term economic and social security. Second, Russia's invasion of Ukraine, linked with energy and food insecurity in Europe,[11,12&13] led to an acceleration of EU de-risking efforts, with a consensus among

1 This trend accelerated following the global financial crisis (GFC) in 2008. Many other countries have also become more risk aware and have implemented some form of industrial policy aimed at protecting domestic interests since the GFC, which saw the first cracks begin to appear in the perception that globalisation is *the* model for universal growth. In response to the ensuing global economic downturn, governments around the world began erecting protectionist walls and introducing industrial policy measures, such as subsidies, in an attempt to bolster domestic industrial competitiveness, safeguard well-paid jobs at home and ensure an optimal position for their domestic industries in global value chains. Since 2008, 110 countries—responsible for 90 per cent of the global economy—have adopted some form of industrial policy measures: Aiyar, Shekar; Chen, Jiaqian; Ebeke, Christan; Garcia-Saltos, Roberto; Gudmundsson, Tryggvi; Ilyina, Anna; Kangur, Alvar; Kunaratskul, Tansaya; Roriguez, Sergio; Ruta, Michele; Schulze, Tatjana; Soderberg, Gabriel & Trevino, Juan Pedro, *Geoeconomic Fragmentation and the Future of Multilateralism,* International Monetary Fund, 15th January 2023, viewed 15th December 2023, <https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2023/01/11/Geo-Economic-Fragmentation-and-the-Future-of-Multilateralism-527266>

2 *World Investment Report 2020: International Production beyond the Pandemic,* UNCTAD, 16th June 2020, viewed 15th December 2023, <https://unctad.org/system/files/official-document/wir2020_en.pdf>

3 Benner, Thorsten, *Scholz's Asia Month: Preparing Germany for a Non-Western-Centric World,* Global Public Policy Institute, 10th November 2022, viewed 7th December 2023, <https://gppi.net/2022/11/10/scholzs-asia-month-preparing-germany-for-a-non-western-centric-world>

4 *Speech by President von der Leyen on EU-China relations to the Mercator Institute for China Studies and the European Policy Centre*, European Commission, 30th March 2023, viewed 27th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/speech_23_2063>

5 Brzozowski, Alexandra, *Von der Leyen wants 'de-risking' not 'de-coupling' in new China doctrine, Euractiv*, 30th March 2023, viewed 27th December 2023, <https://www.euractiv.com/section/eu-china/news/von-der-leyen-wants-de-risking-not-de-coupling-in-new-china-doctrine/>

6 *European Council: 19/20 December 2013 Conclusions*, European Council, 20th December 2013, viewed 7th December 2023, <https://data.consilium.europa.eu/doc/document/ST-217-2013-INIT/en/pdf#:~:text=The%20European%20Council%20calls%20on,supported%20by%20a%20more%20integrated%2C>

7 Former Commission President Jean-Claude Juncker stated in 2017, "Let me say once and for all: we are not naïve free traders. Europe must always defend its strategic interests […]It is a political responsibility to know what is going on in our own backyard so that we can protect our collective security if needed." *State of the Union 2017 – Trade Package: European Union proposes framework for screening of foreign direct investments*, European Commission, 14th September 2017, viewed 3rd June 2018, <http://europa.eu/rapid/press-release_IP-17-3183_en.htm>

8 *How the EU responds to crises and builds resilience*, European Council, viewed 28th December 2023, <https://www.consilium.europa.eu/en/policies/eu-crisis-response-resilience/>

9 *COVID-19 Clearing House for medical equipment,* European Commission, viewed 28th December 2023, <https://commission.europa.eu/strategy-and-policy/coronavirus-response/emergency-support-instrument/covid-19-clearing-house-medical-equipment_en>

10 Payne, Julia, *EU sets up new mechanisms to stave off medicine shortages, Reuters,* 25th October 2023, viewed 28th December 2023, <https://www.reuters.com/world/europe/eu-sets-up-new-mechanisms-stave-off-medicine-shortages-2023-10-24/>

11 Ellyat, Holly, *The U.S. was right – Europe has become a 'hostage' to Russia over energy, analysts warn,* CNBC, 7th October 2021, viewed 28th December 2023, <https://www.cnbc.com/2021/10/07/europe-is-now-a-hostage-to-russia-over-energy.html>

12 Hayden, Jones, *Kremlin accused of 'weaponizing food' in halt of Ukraine grain deal, Politico,* 30th October 2022, viewed 28th December 2023, <https://www.politico.eu/article/russia-ukraine-grain-deal-grain/>

13 Zachmann, Georg; Weil, Pauline & von Cramon-Taubadel, Stephan, *A European policy mix to address food insecurity linked to Russia's war,* Bruegel, 9th December 2022, viewed 28th December 2023, <https://www.bruegel.org/policy-brief/european-policy-mix-address-food-insecurity-linked-russias-war>

Commission officials that the bloc could never again allow itself to be held hostage to critical resources. It has already taken steps in this direction, for example with plans to diversify its supply chains away from one single source for both energy and raw materials.[14&15]

The EU has so far been careful to develop its de-risking toolkit in a way that minimises the impact that it could have on its engagement with its trade and investment partners. For example, the approach it has taken to identifying what constitutes a critical dependency and to what extent they should be de-risked, has so far been forensic.[16&17] However, von der Leyen's March 2023 speech, in which she explained some of the key principles of de-risking—while delivering more assertive comments on the EU's China policy than had perhaps been previously articulated—was not well received by China. One official expressed disappointment, saying that the speech misrepresented and misinterpreted Chinese policies and positions. Another warned of the "risk of linking trade with ideology and national security and creating bloc confrontation."[18]

Just two months later, when the term 'de-risking' appeared in the joint communiqué issued by the Group of Seven (G7), following its May 2023 meeting in Japan, Chinese State media claimed that "de-risking is just decoupling in disguise", and that "so-called de-risking is just another pretext fabricated by Washington to contain China."[19] However, this is something of a misinterpretation, as it belies the fact that the term 'de-risking' originated in Europe, in order to distinguish the bloc's objective of taking a precise approach to economic security, risk management and diversification, from broader decoupling, something that has been more associated with the US. It also distracts from the fact that China has seemingly been pursuing its own—far more comprehensive—form of risk management that predates EU de-risking by quite some time. Perhaps most importantly, it obfuscates the underlying reason that the EU has found itself compelled to develop a de-risking toolkit in the first place, which is to defend itself from an increasing number of challenges to its own security, due to distortions and other threats emanating from third markets.[20]

China's own approach was initially informed by a recognition of the need to build domestic industrial capabilities, mostly predicated on the desire to develop its economy and provide increased prosperity for its people. It has been steered through a planned, top-down approach, with the perceived level of risk awareness—and subsequent policies adopted—evolving significantly from the early 1990s until the present day.

Starting around the mid-2000s, the drive for indigenous innovation was strengthened with industrial policies that were designed to enable China to catch-up in both core technologies and industries identified as strategic.[21] They were gradually tweaked in terms of scope and ambition to increase China's global competitiveness, with domestic and global market share targets being added.[22] In parallel to its industrial policies, China's five-year plans increasingly amplified security components alongside those related to development, a theme that has also been echoed in top-

14 *Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions: REPowerEU Plan,* European Commission, 18th May 2022, viewed 28th December 2023, <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52022DC0230>

15 *Critical Raw Materials Act,* European Commission, viewed 28th December 2023, <https://single-market-economy.ec.europa.eu/sectors/raw-materials/areas-specific-interest/critical-raw-materials/critical-raw-materials-act_en>

16 Arjona, Roman; Connell, William & Herghelegiu, Cristina, *An enhanced methodology to monitor the EU's strategic dependencies and vulnerabilities*, European Commission, 18th April 2023, viewed 7th December 2023, <https://single-market-economy.ec.europa.eu/publications/enhanced-methodology-monitor-eus-strategic-dependencies-and-vulnerabilities_en>

17 *Critical Raw Materials: ensuring secure and sustainable supply chains for EU's green and digital future*, European Commission, 16th March 2023, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/ip_23_1661>

18 Camut, Nicolas, *China lashes out at von der Leyen over fiery remarks, Politico,* 31st March 2023, viewed 27th December 2023, <https://www.politico.eu/article/china-eu-ursula-von-der-leyen-remark-fu-cong-wang-lutong/>

19 *Xinhua Commentary: De-risking is just decoupling in disguise, Xinhua*, 26th May 2023, viewed 27th December 2023, <https://english.news.cn/20230526/f534dc97c66f43e98b1a7642d07221c8/c.html>

20 Notably, the EU has experienced some of these challenges disproportionately with regard to China, including: a lack of reciprocity in terms of both general market access and public procurement; economic coercion against member states; industrial policies and subsidisation of Chinese companies leading to overcapacity that distorts competition in the EU market; and state-backed investments into critical infrastructure and technologies in the EU that could potentially impact security. Hence the EU's de-risking measures, while not aimed specifically at China, have a strong 'China component'.

21 These include, for example, *The National Medium- and Long-term Programme for Science and Technology Development (2006–2020) (MLP), the 2010 Strategic Emerging Industries (SEI)* initiative and 2015's *Made in China 2025*. All three of these policies cited explicit security objectives. For example, the MLP had a specific focus on both China's military defence capability and food security.

22 Leahy, Joe; Kynge, James & Yu, Sun, *The looming trade tensions over China's subsidies, Financial Times*, 30th January 2024, viewed 31st January 2024, <https://www.ft.com/content/a5101a0d-a1bf-4591-82f1-4fd9a5fadbec>

level announcements.[23]

This approach further accelerated in reaction to increasing US-China strategic competition, and particularly after a trade war was subsequently launched by the Trump administration in 2018.[24] In President Xi Jinping's April 2020 Central Financial and Economic Commission address, he outlined the need for China to build "independent, controllable, secure and reliable industrial and supply chains," while also "deepening the dependence of international industrial chains on China, in order to develop a powerful deterrent against attempts by other countries to artificially cut off our supply chains."[25]

China's security and development concerns eventually converged, culminating in the emergence of the concept of 'coordinated development and security', which has become a top-level policy priority under the umbrella of the 14th Five-year Plan. Then, during the 20th Party Congress in 2022, the need to enhance national security and social stability was emphasised—implying the prioritisation of security in the context of economic policy—as was Beijing's desire to intensify its technological self-reliance.[26] The breadth and depth of China's approach to risk management and strengthening economic security therefore seems to go far beyond the EU's desire to eliminate critical dependencies and potential distortions in its own market while remaining as open as possible.

For its part, the US has moved away from its rhetoric of 'decoupling', as first advocated by some in the Trump administration (2017–2021)—which called for a broad reversal of economic interdependencies with China—in favour of 'de-risking'.[27] This is largely due to the recognition that completely severing ties with China would have a devastating impact on both its own and the global economy.[28] However, the US' adoption of the term 'de-risking' has also created a perception that its approach is more closely aligned with the EU's than perhaps it actually is, which has muddied the waters. Similar to the EU, the US aims to build domestic industrial capabilities and bolster its competitiveness in certain industries. However, there is a perception in the Chinese Government that a significant part of the US' strategy also involves taking pre-emptive measures that will impede China's development,[29] to maintain its own dominant position in the global economy, which is not a characteristic of EU de-risking.

From a company perspective, efforts to eliminate risk from their operations and decision-making processes is simply something they have always done. However, the challenges now being faced by many European firms in China, much of them resulting from the hyper concentration of supply chains in the country, suggests that competitive dynamics drove many to deprioritise resilience over the past decade or so. The volume, complexity and severity of the risks that they face have all grown exponentially in recent years, as politics has slowly seeped into the business environment, a trend that has been building up a head of steam since the GFC. Incidents such as China's curbing of rare earth exports to Japan in 2010, as a result of a bilateral disagreement, was an early indicator of how businesses could become increasingly drawn into and impacted by geopolitical issues.[30]

In the European Chamber's *Business Confidence Survey 2023*, a record 64 per cent of respondents noted that doing business in China had become more difficult year-on-year. Long-standing challenges, such as market access and

23 For example: 1) President Xi Jinping introduced the "comprehensive national security concept" in 2014; and 2) the 14th Five-Year Plan (14FYP; 2021–2025), explicitly outlines the need for China to reduce its reliance on the global economy and increase its self-reliance, exemplified by its dual circulation policy.

24 Wolf, Martin, *Donald Trump declares trade war on China, Financial Times*, 8th May 2018, viewed 28th December 2023, <https://www.ft.com/content/dd2af6b0-4fc1-11e8-9471-a083af05aea7>

25 *Issues Paper: Strategic Autonomy, Strategic Choices*, Council of the European Union, 5th February 2021, viewed 27th December 2023, <https://www.consilium.europa.eu/media/49404/strategic-autonomy-issues-paper-5-february-2021-web.pdf>

26 Despite official policy stipulating that security and development should be coordinated, China's COVID management measures provide a clear example of how security has taken precedence in practice. The damage this inflicted on China's economic development was extensive and the effects are still being felt today.

27 Alvarado, Gabriel, *The United States has a message for China: Yes, de-risking is possible, New Atlanticist*, 21st August 2023, viewed 28th December 2023, <https://www.atlanticcouncil.org/blogs/new-atlanticist/the-united-states-has-a-message-for-china-yes-de-risking-is-possible/>

28 Heng, Weili, *Yellen opposes China 'decoupling', China Daily,* 21st April 2023, viewed 12th December 2023, <https://www.chinadaily.com.cn/a/202304/21/WS6441f20aa310b6054faceefd.html>

29 McDonald, Joe, *Xi accuses US of trying to hold back China's development, AP,* 9th March 2023, viewed 9th February 2024, <https://apnews.com/article/china-us-relations-sabotage-development-taiwan-cb60a10bc988243af53c98f2c9e92104>

30 Tabeta, Shunsuke, *China tightens rare earth export curbs amid tension with the U.S., Nikkei Asia*, 7th November 2023, viewed 28th December 2023, <https://asia.nikkei.com/Spotlight/Supply-Chain/China-tightens-rare-earth-export-curbs-amid-tension-with-U.S>

regulatory barriers, unequal treatment and burdensome administrative requirements, have been exacerbated by global events, such as the COVID-19 pandemic and Russia's invasion of Ukraine, as well as unforeseen occurrences such as the blocking of the Suez Canal when a ship ran aground. This came on top of worries about the Chinese and global economic slowdown as well as impacts from the US-China trade war.[31] As a result, business plans are now skewed disproportionately towards risk management and building resilience rather than cost saving, optimising efficiency and increasing market share.

Some of the main risks currently faced by European companies in China that were interviewed for this report include: detaching completely from the Chinese market; overexposure to the Chinese market; geopolitics; supply chain disruptions; conflicts between the EU's and China's respective legal regimes; and non-compliance with China's cybersecurity legislation. Interviews made clear that there is no 'one size fits all' approach to managing such risks, with many different strategies being adopted even among companies of a similar size within the same industry. Strategies may be based on a given company's risk appetite, its anticipation of China's future trajectory, or simply in response to market changes and evolving business or customer needs, as well as a company's past successes and current footprint in China. In some cases, they can even be guided by an individual executive's general sentiment towards China.

Conclusion

An environment of heightened risk is anathema for business, as companies should be devoting resources to developing better products and services, not increasing their budgets for risk assessments and compliance efforts. Some of the approaches that companies are now having to adopt entail a significant loss of efficiency, which further increases operating costs, impacts innovation, and will ultimately result in increased costs being passed on to consumers, which will not benefit anyone.

While the three respective strategies currently being pursued by the EU, China and the US all represent a retreat to varying degrees from globalisation as we know it, from a business point of view it is important to aim for the 'least expensive' solution. In this regard, the EU concept of de-risking, as presently defined, represents the most acceptable approach. Unlike China, the EU is not pursuing policies aimed at attaining self-reliance, but rather diversification that will allow its supply chains to continue with minimal disruption. The EU's overall aim is also not to decouple, but rather to maintain engagement with its partners, while becoming better at identifying and managing risk based on precise identification of critical dependencies. This should result in new trade opportunities, the adoption of bespoke approaches to risk management and a continued emphasis on remaining highly integrated with the global economy.

The overall aims of this report are to:

- clearly differentiate between the respective forms of risk management being adopted by the EU, China and the US, and address some of the misconceptions that have emerged;
- enable all stakeholders to engage in a fact-based discussion around the potential impacts on business and find ways to deepen cooperation wherever possible;
- inform European businesses' future engagement in and with the Chinese market; and
- provide high-level recommendations for European and Chinese policymakers, with the intention of minimising the impact of 'de-risking' on business.

31 *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, 21st June 2023, viewed 14th December 2023, <https://europeanchamber.oss-cn-beijing.aliyuncs.com/upload/documents/documents/European_Business_in_China_Business_Confidence_Survey_2023[1124].pdf>

EU DE-RISKING: STRENGTHENING ECONOMIC SECURITY AND REDUCING CRITICAL DEPENDENCIES

"Global integration and open economies have been a force for good for our businesses, our competitiveness, and our European economy. And that will not change in the future. But we also have to be clear-eyed about a world that has become more contested and geopolitical. This is why the topic of economic security has become a priority for us and for many of our partners. And today, Europe becomes the first major economy to set out a strategy on economic security. It will ensure Europe's sovereignty, security and prosperity in the years to come."

Ursula von der Leyen
President of the European Commission
20th June 2023

Introduction

Broadly speaking, the EU's de-risking strategy is a result of its evolving assessment of the risks brought about by globalisation, leading to a recognition that its security is, to a large extent, dependent on becoming more resilient.[32]

Following the 2008 global financial crisis (GFC) the geopolitical climate has been shaped by a rise in economic protectionism, with several key factors having contributed to a steady erosion of global interdependencies. These include: growing US-China tensions; mercantilist Chinese trade practices, including the promulgation of domestic technology standards, onerous requirements for obtaining operating licences and discrimination in public procurement; supply chain disruptions following the COVID-19 pandemic, Russia's invasion of Ukraine, and its weaponisation of food and energy supply chains; and an increasingly dysfunctional World Trade Organization (WTO). Against this backdrop, the EU's de-risking strategy is aimed at enhancing economic security and, as a corollary, physical security, to ensure the prosperity of the Union.[33]

EU de-risking measures and tools are being put in place to minimise "risks arising from certain economic flows in the context of increased geopolitical tensions and accelerated technological shifts", while being designed in such a way that they "preserv[e] maximum levels of economic openness and dynamism".[34] For example, in June 2023, the European Council announced that the EU will, in line with the Versailles Agenda of March 2022,[35] continue to reduce critical dependencies and vulnerabilities, and "de-risk and diversify" from China, only "where necessary and appropriate", while continuing to engage significantly as it seeks to establish a relationship that is "balanced, reciprocal and mutually beneficial."[36]

Importantly, the EU has been clear that de-risking is not to be equated with decoupling, noting that decoupling with China—which would imply deglobalisation—is "neither viable – nor in Europe's interest".[37] This sentiment was reiterated by EU Trade Commissioner Valdis Dombrovskis ahead of the 2023 EU-China High Level Economic and Trade Dialogue, when he noted that, despite the many issues the EU has with China, the EU is "discussing 'de-risking'

32 *Joint communication to the European Parliament, the European Council and the Council on "European Economic Security Strategy",* EUR-Lex, 20th June 2023, viewed 7th December 2023, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52023JC0020&qid=1687525961309>

33 *An EU approach to enhance economic security,* European Commission, 20th June 2023, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3358>

34 Ibid.

35 *Informal meeting of the Heads of State of Government: Versailles Declaration, 10 and 11 March 2022,* 11th March 2022, viewed 7th December 2023, <https://www.consilium.europa.eu/media/54773/20220311-versailles-declaration-en.pdf>

36 *European Council conclusions on China,* European Council, 30th June 2023, viewed 7th December 2023, <https://www.consilium.europa.eu/en/press/press-releases/2023/06/30/european-council-conclusions-on-china-30-june-2023/>

37 *Speech by President von der Leyen on EU-China relations to the Mercator Institute for China Studies and the European Policy Centre,* European Commission, 30th March 2023, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/speech_23_2063>

not 'decoupling'," noting that the EU needs "to find ways to co-operate with China while addressing risks and possible strategic dependencies".[38]

Key concerns and drivers of EU de-risking

Speaking at her inauguration in 2019, Commission President von der Leyen proclaimed that she would be leading a "geopolitical commission" that would "promote and protect" European interests.[39] In 2020, the EU published *A new Industrial Strategy for globally competitive, green and digital Europe*, to strengthen its strategic autonomy and industrial competitiveness.[40] Although EU policymakers noted that this was about preserving "Europe's sovereignty", with the goal of driving the transformation of the EU economy towards becoming more sustainable, digital and resilient, the strategy already hinted at the need to reduce strategic dependences. This was complemented by a February 2021 announcement setting out the EU's trade strategy. One of the three main pillars outlined in the trade strategy is "increasing the EU's capacity to pursue its interests and enforce its rights, including autonomously where needed". It also puts a strong emphasis on diversifying trade relationships in order to enhance the resilience of supply chains.[41]

While these are relatively recent developments, they are part of a longer trend, with discussions on European strategic autonomy—in relation to both security and defence, and economic policy—increasing in both frequency and scope over the years. As far back as December 2013, for instance, the European Council-approved conclusions on civilian *Common Security and Defence Policy* (CSDP) identified a need for a "European defence technological and industrial base" that would be able to "enhance its strategic autonomy and its ability to act with partners".[42] Four years later, the idea of introducing a framework for a foreign direct investment (FDI) screening mechanism was formally proposed by then Commission President Jean-Claude Juncker during his State of the Union Address on 13th September.[43] He stated, "[EU Member States] are not naïve free traders. Europe must defend its strategic interests[…]It is a political responsibility to know what is going on in our own backyard so that we can protect our security if needed."[44] The Foreign Investment Screening Regulation, which became fully operational on 11th October 2020, has been put in place to ensure that the European market can remain fully open but not be taken advantage of or compromised.

As already alluded to, alongside concerns about the deterioration of the US-China relationship, EU de-risking has been informed by Europe's changing perceptions of China, with President von der Leyen stating in 2023 that the country is "becoming more repressive at home and more assertive abroad".[45] She argued that the evolution of how China is viewed has been driven by a number of factors. These include the introduction of a wide range of security-orientated laws and several alleged human rights violations in China; an approach to global politics and trade wherein China's "imperative for security and control now trumps the logic of free markets and open trade"; and by what the EU perceives as China's clear intent to revise the international order—under which the EU, China and the US have all thrived—and put itself at its centre.[46] All of this has come on top of long-standing concerns with regard to China,

38 Bounds, Andy & Fleming, Sam, *EU trade chief to push China on barriers to exports, Financial Times*, 7th August 2023, viewed 7th December 2023, <https://www.ft.com/content/23057678-fc62-42aa-93dc-dd1752f723d3>

39 *Speech by President-elect von der Leyen in the European Parliament Plenary on the occasion of the presentation of her College of Commissioners and their programme*, European Commission, 29th November 2019, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_19_6408>

40 *Making Europe's businesses future-ready: A new Industrial Strategy for a globally competitive, green and digital Europe*, European Commission, 10th March 2020, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/ip_20_416>

41 *Commission sets course for and open, sustainable and assertive EU trade policy,* European Commission, 18th February 2021, viewed 7th February 2024, <https://ec.europa.eu/commission/presscorner/detail/en/ip_21_644>

42 *European Council: 19/20 December 2013 Conclusions*, European Council, 20th December 2013, viewed 7th December 2023, <https://data.consilium.europa.eu/doc/document/ST-217-2013-INIT/en/pdf#:~:text=The%20European%20Council%20calls%20on,supported%20by%20a%20more%20integrated%2C>

43 One of the main drivers behind the establishment of the screening mechanism was the 'shopping spree' among Chinese investors in the EU in the mid-2010s, which included Midea's acquisition of Kuka, considered one of the 'crown jewels' of German industry.

44 *State of the Union 2017 – Trade Package: European Union proposes framework for screening of foreign direct investments,* European Commission, 14th September 2017, viewed 3rd June 2018, <http://europa.eu/rapid/press-release_IP-17-3183_en.htm>

45 *Speech by President von der Leyen on EU-China relations to the Mercator Institute for China Studies and the European Policy Centre,* European Commission, 30th March 2023, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/speech_23_2063>

46 Ibid.; *Speech by President von der Leyen at the European China Conference 2023 organised by the European Council on Foreign Relations and the Mercator Institute for China Studies*, European Commission, 16th November 2023, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/speech_23_5851>

including market access issues, a lack of regulatory reform, the unlevel playing field that European companies face and market distortions caused by Chinese state subsidies. The need to address many of these concerns culminated with the Commission publishing *EU-China: A Strategic Outlook* (*Strategic Outlook*) in 2019,[47] which forms the overall framework for EU-China relations.

More recent developments, however, amplified the need to take a more concerted and strategic approach to risk management, rather than reacting to both specific concerns pertaining to China or other third countries, and geopolitical events. First, the COVID-19 pandemic "exposed the interdependence of global value chains",[48] particularly regarding material imports, including critical healthcare equipment and raw materials.[49&50] This resulted in the EU updating its European Industrial Strategy in 2021, with key proposals designed to enhance the resilience of the EU Single Market,[51] and strengthen the EU's strategic autonomy.[52]

Then, in February 2022, Russia's invasion of Ukraine led to a major destabilisation of both the global order and the EU's neighbourhood. Moscow's subsequent weaponisation of energy dependencies,[53] and the looming threat of a food crisis in both Europe and the rest of the world,[54] further highlighted the EU's vulnerability to economic coercion.[55] In response, EU leaders adopted the Versailles Declaration in March 2022, just weeks after Russia's war of aggression began.[56] Although it does not contain the term specifically, the declaration effectively sets down de-risking as a cornerstone of EU strategic thinking, laying the foundation for the de-risking measures subsequently announced in 2023. In addition to reiterating the need for the EU to bolster its defensive capabilities, the declaration lays out a pathway for reducing EU energy dependencies, and building a more robust economic base. It also puts forward steps to reduce strategic dependencies, including in the domain of critical raw materials, semiconductors, digital technologies, and health and food products.[57]

Other experiences of economic coercion against EU Member States, particularly China's blocking the import of products, or products that contain components, from Lithuania, following the opening of a Taiwan representative office in Vilnius,[58] convinced Brussels that more needs to be done to ensure economic relations with China are more balanced and fairer. Meanwhile, Chinese large-scale military exercises in the Taiwan Strait following the visit of then US House of Representatives Speaker Nancy Pelosi to Taiwan have further strengthened the view that worst-case scenarios are possible, and resulted in many companies carrying out their own risk assessments, to map out the impact of any potential escalation of tensions in the Taiwan Strait.[59]

47 *EU-China: A Strategic Outlook,* European Commission, 12th March 2019, viewed 7th December 2023, <https://commission.europa.eu/system/files/2019-03/communication-eu-china-a-strategic-outlook.pdf>

48 *European Industrial Strategy,* European Commission, viewed 7th December 2023, <https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/europe-fit-digital-age/european-industrial-strategy_en>

49 This included personal protective equipment (PPE), such as masks and hazmat suits, testing equipment, pharmaceuticals and medical devices.

50 Peel, Michael & Sanderson, Henry, *EU sounds alarm on critical raw materials shortage, Financial Times,* 31st August 2020, viewed 1st February 2024, <https://www.ft.com/content/8f153358-810e-42b3-a529-a5a6d0f2077f>

51 These include proposals for the Single Market Emergency Instrument (SMEI): *Single market emergency instrument*, European Commission, viewed 15th December 2023, <https://single-market-economy.ec.europa.eu/single-market/single-market-emergency-instrument_en>; and deepening and further integrating the Single Market: *The Single Market at 30*, European Parliament, June 2023, viewed 15th December 2023, <https://www.europarl.europa.eu/RegData/etudes/BRIE/2023/749771/EPRS_BRI(2023)749771_EN.pdf#:~:text=In%20May%202022%2C%20the%20plenary%20of%20the%20Conference,on%20the%2030th%20anniversary%20of%20the%20single%20market.>

52 Including by diversifying international partnerships, building industrial alliances and monitoring strategic dependencies.

53 Lawson, Alex, *'Gas blackmail': how Putin's weaponised energy supplies are hurting Europe, The Guardian*, 15th July 2022, viewed 7th December 2023, <https://www.theguardian.com/world/2022/jul/15/gas-blackmail-how-putins-weaponised-energy-supplies-are-hurting-europe>

54 Borger, Julian, *Turning food into a weapon: how Russia resorted to one of the oldest forms of warfare, The Guardian*, 9th August 2023, viewed 7th December 2023, <https://www.theguardian.com/world/2023/aug/09/mines-drone-strikes-organised-plan-to-export-ukraine-grain-via-danube-ports-is-no-easy-fix>

55 This was already a concern in the EU. The proposal for a tool to protect its member states from economic coercion had already been made on 8th December 2021: *EU strengthens protection against economic coercion*, European Commission, 8th December 2021, viewed 1st February 2024, <https://ec.europa.eu/commission/presscorner/detail/en/ip_21_6642>

56 *Informal meeting of the Heads of State of Government: Versailles Declaration, 10 and 11 March 2022*, 11th March 2022, viewed 7th December 2023, <https://www.consilium.europa.eu/media/54773/20220311-versailles-declaration-en.pdf>

57 Ibid.

58 *China halts Lithuania beef, dairy and beer imports amid Taiwan row, BBC*, 11th February 2022, viewed 7th December 2023, <https://www.bbc.com/news/business-60343316>

59 Hille, Kathrin, *Corporate jitters over Taiwan and China on the rise, Financial Times*, 20th July 2022, viewed 8th December 2023, <https://www.ft.com/content/bfa317e0-743b-4994-a4f5-7c0b25ed9cec>

The direction and scope of EU de-risking

Following the publication of two reports mapping Europe's strategic dependencies in 2021 and 2022, the European Commission and European Council commissioned a further report in April 2023.[60] This latest report found that of the 5,400 HS6 products imported by the EU,[61] 204 are "products in sensitive industrial ecosystems where the EU experiences an important level of foreign dependencies."[62] Of those 204, 64—or 31 per cent—originate from China, with the second highest dependency being on the US, which is the originator of 38 such products, or 19 per cent of the overall proportion. Although the number of Chinese goods within scope is high compared to other countries, they still make up a very small proportion (1.19 per cent) of the overall goods examined. It is equally important to note that the EU is not looking to cease trading with third countries with which it has such dependencies. Rather, the proposal is to spread the risk to ensure sustainable access to critical goods and materials—be it through increasing domestic capacity for such activities as production, extraction and refining, or by establishing a broader network of partners—thereby enhancing its economic security.

An additional illustration of the EU's narrow approach to de-risking through supply diversification can be found in the EU's Critical Raw Materials Act. It sets the benchmark that by 2030, no "more than 65% of the Union's annual consumption of each strategic raw material at any relevant stage of processing" should be sourced from a single third country.[63&64]

In terms of boosting domestic industrial capability, the EU has set targets to incentivise investment in important areas. For example, its Net Zero Industry Act aims to "attract investments and create better conditions and market access for clean tech in the EU", and sets the goal for the EU to be able to produce 40 per cent of its deployment needs in technologies that will facilitate both its 2030 climate goals and the transition to becoming carbon neutral by 2050.[65] Similarly, the European Chips Act aims to "reinforce the semiconductor ecosystem in the EU, ensure the resilience of supply chains and reduce external dependencies." It sets the goal of achieving a 20 per cent global market share in semiconductors by "building and reinforcing Europe's capacity to innovate in the design, manufacturing and packaging of advanced chips [and] putting in place an adequate framework to increase production by 2030", among others.[66]

Although the wider recognition of strategic vulnerabilities, and subsequent identification of where they lie, has further fed the appetite for de-risking, the EU continues to identify the majority of its trading relationship with China as mutually beneficial. As such, it aims to maintain significant economic relations,[67] in line with Brussel's official policy that identifies China as a cooperation and negotiation partner, economic competitor and systemic rival.[68] As already alluded to, the bulk of EU-China trade would not be impacted by measures taken to find alternative sources for the 64 critical goods, again highlighting the comparatively narrow and targeted nature of EU de-risking.

This is further reflected in the principles of precision and proportionality that underpin the European Economic

60 Arjona, Roman; Connell, William & Herghelegiu, Cristina, *An enhanced methodology to monitor the EU's strategic dependencies and vulnerabilities*, European Commission, 18th April 2023, viewed 7th December 2023, <https://single-market-economy.ec.europa.eu/publications/enhanced-methodology-monitor-eus-strategic-dependencies-and-vulnerabilities_en>

61 Harmonised System 6 (HS6) – a standardised system for classifying traded goods.

62 Ibid.

63 *Critical Raw Materials Act*, European Commission, 2023, viewed 1st February 2024, <https://single-market-economy.ec.europa.eu/sectors/raw-materials/areas-specific-interest/critical-raw-materials/critical-raw-materials-act_en>

64 *Critical Raw Materials: ensuring secure and sustainable supply chains for EU's green and digital future*, European Commission, 16th March 2023, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/ip_23_1661>

65 *Net Zero Industry Act,* European Commission, viewed 7th February 2024, <https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/green-deal-industrial-plan/net-zero-industry-act_en>

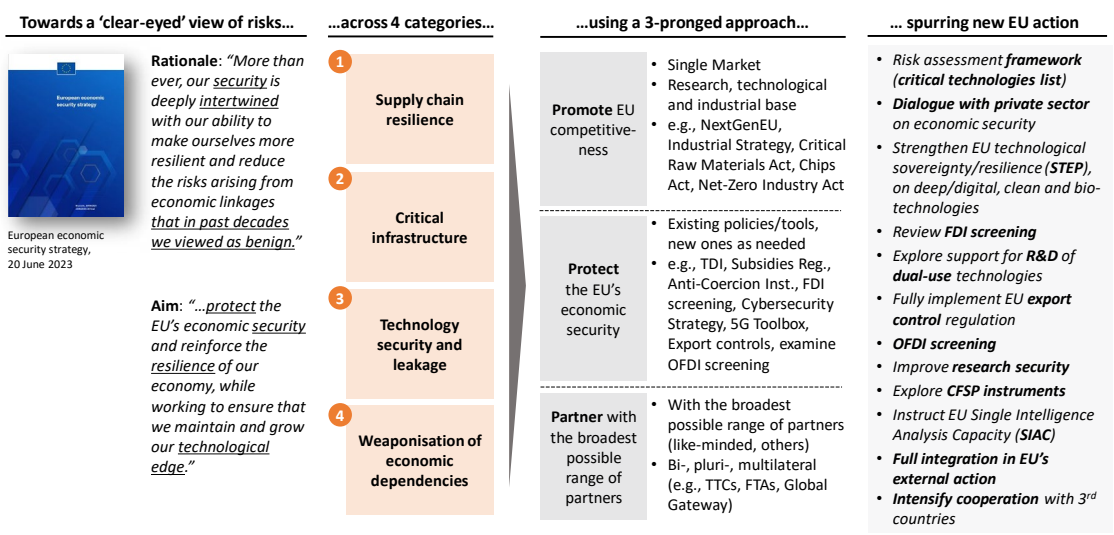
66 *Shaping Europe's digital future: European Chips Act,* European Commission, last updated 20th January 2024, viewed 7th February 2024, <https://digital-strategy.ec.europa.eu/en/policies/european-chips-act>

67 *Speech by President von der Leyen on EU-China relations to the Mercator Institute for China Studies and the European Policy Centre*, European Commission, 30th March 2023, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/speech_23_2063>

68 *EU-China Relations Factsheet,* European External Action Service, 7th December 2023, viewed 8th December 2023, <https://www.eeas.europa.eu/eeas/eu-china-relations-factsheet_en>

Security Strategy (EESS).[69] Although there is an important China component to the EESS—given that many of the areas it looks to strengthen relate to challenges that it is facing disproportionately with regard to China—the EU has framed the strategy as 'country-agnostic', as is the case for other instruments in its defensive toolbox. It is designed to tackle four risk areas—supply chain resilience, critical infrastructure, technology security and leakage, and weaponisation of economic relations. It proposes carrying out risk assessments in these four areas, and contextualises existing measures within the framework of de-risking, packaging them into a more coherent toolkit.

Figure 1: The EU's country-agnostic economic security strategy



Source: European Economic Security Strategy (EESS)

By highlighting its China-orientation, the EESS builds on assessments and measures already outlined in the *Strategic Outlook*.[70&71] The *Strategic Outlook* includes a 10-point action plan, which, in the face of an increasingly China-critical European Parliament,[72] has resulted in several measures being signed into action.[73]

However, while the core tenets of the *Strategic Outlook* remain in place, the EESS places less of an emphasis on the EU's longstanding focus on generating reciprocity and a level playing field in its relations with China. Instead, de-risking complements these principles, and other concerns, representing a thorough recalibration towards increasingly proactive and strategic policymaking that prioritises resilience of the European economy. An example of how narrow and targeted this strategy is, is the EU critical technology list, a key deliverable of the EESS, which focuses only on the areas where: 1) an enabling and transformative nature of technology is identified; 2) there are risks of civil and military fusion; and 3) there are risks that the technology could be used in human rights violations, including the restriction of fundamental freedoms.[74] While the list is likely to be updated in the spring of 2024, it currently focuses on four areas related to the EU's economic security – advanced semiconductor technologies, artificial intelligence (AI)

69 *An EU approach to enhance economic security*, European Commission, 20th June 2023, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3358>

70 Most notably the EU's assessment of China being a cooperation partner, an economic competitor and a systemic rival. *EU-China: A Strategic Outlook*, European Commission, 12th March 2019, viewed 7th December 2023, <https://commission.europa.eu/system/files/2019-03/communication-eu-china-a-strategic-outlook.pdf>

71 These include references to foreign subsidies, 5G security and FDI screening.

72 When looking at the previous legislature (2014–2018) compared to the current one (2019–2023), there appears to be a marked shift in the European Parliament's perception of China. According to CMG's assessment, 44 per cent of topics raised from 2014–2018 were those that China deems 'contentious' (e.g., Hong Kong, Taiwan, Human Rights, among others), compared to 73 per cent during the 2019–2023 period.

73 These include the International Procurement Instrument, the EU Foreign Subsidy Regulation and the Foreign Investment Screening Regulation, among others.

74 *Commission recommends carrying out risk assessments on four key critical technology areas: advanced semiconductors, artificial intelligence, quantum, biotechnologies*, European Commission, 3rd October 2023, viewed 8th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/ip_23_4735>

technologies, quantum technologies and biotechnologies.

Statements by President von der Leyen arguing that certain trade and investment relations with China pose risks to the EU's "economic and national security, particularly in the context of China's explicit fusion of its military and commercial sectors",[75] reveal a growing awareness that sensitive emerging technology could be acquired and used for military and/or intelligence purposes.[76] It is within this context that export controls on sensitive technologies and other measures designed to restrict unwanted technology flows to China's military-industrial complex, such as the outbound investment screening mechanism that has been tabled,[77] can be understood.

The idea of implementing comprehensive export controls for dual-use goods that could be used for the purpose of social repression, at home or abroad,[78] suggest a values-driven aspect to de-risking. In this sense, de-risking can also be viewed in the context of how the EU assesses potential threats to its principles with regard to both the current global geostrategic climate on the one hand, and China on the other.[79] As such, the EU has reinforced normative messaging surrounding the "protection of the European way of life" and 'EU values', employing appropriate policy measures, including ones aimed at targeting foreign interference and countering disinformation campaigns.[80,81&82]

Conclusion and outlook

EU de-risking reflects an emerging consensus in both Brussels and member state capitals that threats to the Union's economic security have proliferated in recent years, and that the EU cannot be caught off guard again. The EU increasingly sees itself at risk from practices that challenge its industrial competitiveness in strategic areas, impact its supply chain resilience, threaten its energy security, or increase the possibility of sensitive emerging technologies being acquired and used for military or intelligence purposes. There is also a recognition that the high supply-concentration of critical goods increases the chances of it falling victim to economic coercion. At the same time, it worries about being too exposed to cyber and critical infrastructure attacks, which could threaten its values and the European way of life.

However, de-risking as a policy concept is still evolving. There is still no consensus within the EU on what risks are tolerable, how vulnerabilities can be reduced and what the eventual scope of de-risking should encompass. From a business perspective, it is encouraging that Brussels has so far recognised the need to apply a forensic approach when identifying potential risks, and then be surgical in how it builds its response capability. It is on this basis that the EU's de-risking strategy should continue to be developed.

Increases in de-risking-related measures and signals are expected to further catalyse debates in EU capitals on potential economic chokepoints and where Europe holds technological advantages, leading to policy refinement in how to both protect and promote relevant industries as a means of addressing particular risks.

As European frustrations with China are likely to remain, or even grow, there is room for the EU's toolbox to expand, with proposals for further measures to be developed. These include: reviewing the existing Foreign Investment

75 *Speech by President von der Leyen on EU-China relations to the Mercator Institute for China Studies and the European Policy Centre,* European Commission, 30th March 2023, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/speech_23_2063>

76 *Exporting dual-use items*, European Commission, viewed 8th December 2023, <https://policy.trade.ec.europa.eu/help-exporters-and-importers/exporting-dual-use-items_en>

77 *Outbound investment screening: In "An Economy that Works for People",* Legislative Train Schedule, European Parliament, 20th January 2024, viewed 4th February 2024, <https://www.europarl.europa.eu/legislative-train/theme-an-economy-that-works-for-people/file-outbound-investment-screening>

78 Ibid.

79 The EU's *A Strategic Compass for Security and Defence* identifies "a world shaped by raw power politics, where everything is weaponised and where we face a fierce battle of narratives". *A Strategic Compass for Security and Defence*, European External Action Service, P.4, 21st March 2022, viewed 8th December 2023, <https://www.eeas.europa.eu/sites/default/files/documents/strategic_compass_en3_web.pdf>

80 *Texts adopted: Foreign interference in all democratic processes in the European Union, including disinformation,* European Parliament, 1st June 2023, viewed 8th December 2023, <https://www.europarl.europa.eu/doceo/document/TA-9-2023-0219_EN.html>

81 *Transparency and targeting of political advertising: EU co-legislators strike deal on new regulation,* European Council, 7th November 2023, viewed 8th December 2023, <https://www.consilium.europa.eu/en/press/press-releases/2023/11/07/transparency-and-targeting-of-political-advertising-eu-co-legislators-strike-deal-on-new-regulation/>

82 *Tackling online disinformation*, European Commission, last updated 29th June 2022, viewed 8th December 2023, <https://digital-strategy.ec.europa.eu/en/policies/online-disinformation>

Screening Regulation; engaging in structured dialogues with the private sector on economic security (with a focus on due diligence and risk management); fully implementing EU export control regulations on dual-use items, with enhanced coordination among EU Member States; introducing new measures for enhancing research security; and instructing the EU Single Intelligence Analysis Capacity (SIAC) to work specifically on the detection of possible threats to EU economic security.[83] Underscoring the perceived urgency, the Commission recently presented five new initiatives to strengthen economic security, among them a more detailed proposal to strengthen research security, with a view to safeguarding the Union's academic freedom and institutional autonomy.[84]

There are also growing discussions on supporting individual sectors to increase domestic manufacturing and innovation capabilities (for example, with regard to semiconductors and clean technologies) or to reshore (as is the case for the domestic production of active pharmaceutical ingredients (APIs)).[85] Due to divisions in competencies as outlined in EU treaties, in areas where the EU's competencies are exclusive—such as in the domain of competition and commercial policies—its efforts to de-risk are the most precise and therefore likely to be the most effective.

Importantly, EU de-risking encapsulates its overall strategic goal of striking a balance between upholding economic security while ensuring the benefits of an open economy.[86] In other words, while the EU aims to increase the resilience and stability of its supply chains through increased diversification, it recognises the virtues of fair trade and competition, as well as its continued multilateral presence and engagement.

It is therefore a false premise to conflate EU de-risking with decoupling—which is geared more towards proactive disengagement—or to assume that the EU is not acting independently.[87&88] Rather, the EU has acknowledged the fact that the global, rules-based trading system that has facilitated the growth and stability of so many economies for so long, is now under threat and that action must be taken. Its de-risking strategy represents a realistic approach to continued engagement, while becoming better at identifying risks and taking precise measures to manage them.

83 *An EU approach to enhance economic security,* European Commission, 20th June 2023, viewed 4th February 2024, <https://ec.europa.eu/commission/presscorner/detail/en/IP_23_3358>

84 *Commission proposes new initiatives to strengthen economic security,* European Commission, 24th January 2023, viewed 8th February 2024, <https://ec.europa.eu/commission/presscorner/detail/en/ip_24_363>

85 Fischer, Stefan; Knoll, Verena; Alleweldt, Frank; Vogler, Sabine, *Potential measures to facilitate the production of active pharmaceutical ingredients (APIs),* Directorate-General for Internal Policies, March 2023, viewed 8th December 2023, <https://www.europarl.europa.eu/RegData/etudes/STUD/2023/740070/IPOL_STU(2023)740070_EN.pdf>

86 *An EU approach to enhance economic security,* European Commission, 20th June 2023, viewed 7th December 2023, <https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3358>

87 Bermingham, Finbarr, *Rumblings in the EU ranks as 'de-risking' plan for China gains momentum, South China Morning Post,* 30th July 2023, viewed 8th December 2023, <https://www.scmp.com/news/china/diplomacy/article/3229218/rumblings-eu-ranks-de-risking-plan-china-gains-momentum>

88 Goh, Choon Kang, *Decoupling by another name: The risks of de-risking from China*, Think China, 20th June 2023, viewed 8th December 2023, <https://www.thinkchina.sg/decoupling-another-name-risks-de-risking-china>

CHINA 'DE-RISKING': COORDINATED DEVELOPMENT AND SECURITY

> *"First, we must play to our strengths. We need to consolidate and enhance our international edge in competitive industries; develop technologies that will give us a decisive advantage; continue to strengthen the complete-industrial-chain edge we have in areas such as high-speed rail, electric power equipment, new energy and communications equipment; improve industrial quality; and deepen China's involvement in global industrial chains. By doing so, we will develop an effective deterrent against attempts by other countries to sever our supply chains. Second, we must shore up our weaknesses. We must build homegrown, controllable, secure, and reliable domestic production and supply chains in areas and links vital to our national security, so that they are self-sufficient at critical moments."* [89]

Xi Jinping
General Secretary of the CPC Central Committee
President of the People's Republic of China (PRC)
10th April 2020

Introduction

'De-risking' is not clearly defined in the eyes of Chinese leaders, as was made clear when Chinese Premier Li Qiang criticised the term during the 7th China-Germany inter-governmental consultation in June 2023, saying that it may be used as a cover for 'decoupling'.

However, while there is no unified, formal policy framework for 'de-risking' in China's policymaking, a risk management concept does exist, with related policies identified as those that have an explicit security rationale.[90]

With China a late-joiner to economic globalisation and technologically underdeveloped, former General Secretary Jiang Zemin stated in 1998—three years before China acceded to the WTO in 2001—that China needs to "dare and be good at participating in international economic and technological cooperation and competition". However, he also warned that "various adverse effects and risks" will create challenges in China's opening up process and that "how to seek advantages and avoid disadvantages[…]will always stay a big issue in front of us [摆在我们面前的大问题]". This was effectively an early manifestation of China's risk awareness related to economic interdependence.[91]

In the years following the 17th Party Congress in 2007, policymakers set forth a first set of industrial policies aimed at strengthening China's indigenous industrial capacity focusing on core technologies, especially in "strategic emerging industries", and proposing a deepening of international cooperation in the field of energy, as well as specifically addressing China's food security issues.

In 2012, the 18th Party Congress started to address non-traditional security topics more systematically, such as food security, energy resource security and cybersecurity. And in 2014, during the 1st Plenary Session of the 18th National Security Commission, General Secretary Xi Jinping introduced his theory of the "holistic view of national security" [总体国家安全观], expanding the scope of national security to include economic and societal security. This was

89 *Major Issues Concerning China's Strategies for Mid-to-Long-Term Economic and Social Development,* English Edition of Qiushi Journal, 14th January 2021, viewed 8th February 2024, <http://en.qstheory.cn/2021-01/14/c_604551.htm>

90 China's approach to economic security and risk management can be seen as one of six distinct structural transition processes that China's political economy has been undergoing, namely: 1) economic transition and industrial upgrading, including decarbonisation and digitalisation; 2) market-orientated reforms; 3) economic globalisation; 4) domestic demand system; 5) social rebalancing and market governance; and 6) risk management and economic security.

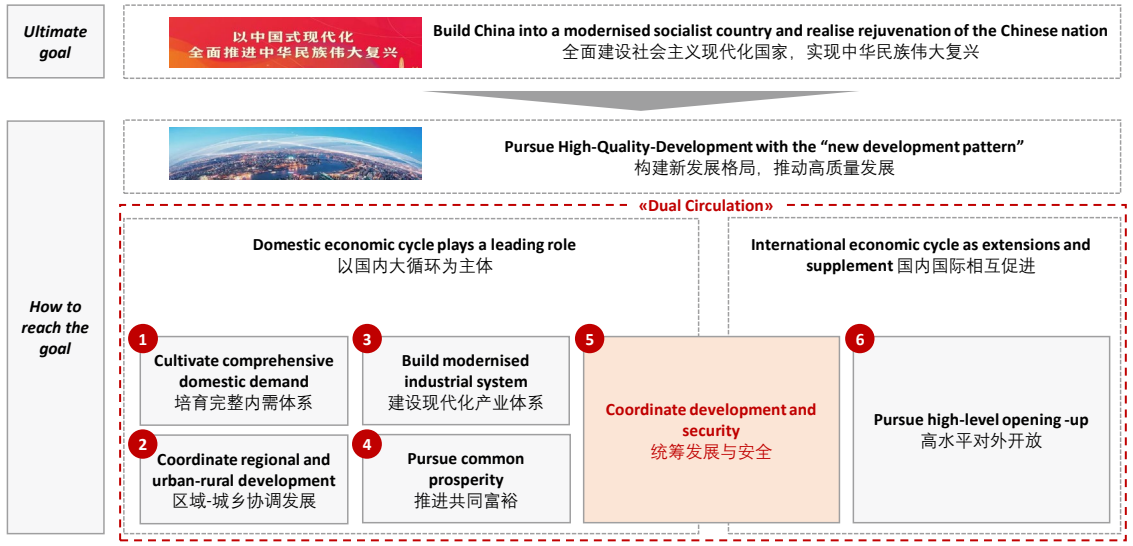
91 *An Examination of Jiang Zemin's Economic Globalization Thought,* Reformdata.org, 26th October 2009, viewed 12th January 2024, <http://www.reformdata.org/2009/1026/7446.shtml>

eventually canonised as comprising sixteen security concepts in 2018 (see Appendix C).[92] In the same year, Xi stated that "there is a need to attach importance to both development issues and security issues".

China's approach to risk management was strongly shaped by both the trade war with the US and the COVID-19 pandemic, as these experiences highlighted China's over-reliance on Western technology, and especially its vulnerability to supply chain disruptions. It was with the 14th Five-year Plan (14FYP) in 2021 that risk management, encapsulated by the concept "coordinate development and security"[93] [统筹发展与安全], became a top-level policy, and was enshrined in the CCP Constitution at the 20th Party Congress in October 2022.

The significance of this risk management policy formula cannot be overstated for two reasons. First, being a component of the 'dual circulation' policy, it is placed at the top-level of the Chinese policy hierarchy, wielding broad influence over any lower-level policymaking.

Figure 2: China's risk management as a top-level policy, and a component of dual circulation



Second, it is a policy formula that demands more weight be given to security needs by stipulating that they be balanced against those of development needs. By doing so it signifies a recalibration of the 'Party's basic line' [党的基本路线], introduced under Deng Xiaoping, that placed the sole policy priority on economic development [以经济建设为中心].[94] The security aspect of this policy formula was further described as being "the prerequisite of development, while development is the guarantee of security".[95]

Jiang's early analysis of the risks associated with economic globalisation has thus—over a period of two decades—evolved into a comprehensive top-down risk management approach that has no clearly delineated policies or instruments, but that empowers Party organs and the State bureaucracy to actively explore necessary measures to respond to China's security needs.

92 *Excerpts from Xi Jinping's Discourse on the 'Holistic View of National Security'*, 2018, link: <https://www.12371.cn/special/xxzd/dzs/8/>

93 Accordingly, the 14FYP (2021–2025) contained—for the first time since the first FYP in 1953—a dedicated chapter on national security.

94 "Economic development as the centre[…]all other tasks must be subordinate to economic development and must not interfere with or disrupt it", *Red Flag Manuscript*, 11th January 2022, viewed 24th December 2023, <http://www.qstheory.cn/dukan/hqwg/2022-01/11/c_1128251185.htm>; Cui, Dong, *Persist in 100 years (Comprehensively and Strictly Governing the Party Face to Face), People's Daily,* 25th April 2017, viewed 24th December 2023, <http://politics.people.com.cn/n1/2017/0425/c1001-29232908.html>

95 *Learning the Spirit of the Fifth Plenary Session of the 19th CPC Central Committee, Xinhua*, 4th November 2020, viewed 10th November 2024, <http://www.xinhuanet.com/politics/2020-11/04/c_1126698536.htm>

Despite the "coordinate development and security" policy formula outwardly being clear, its boundaries actually seem to be still in flux, as shown by two examples. First, in the face of a slower than expected economic recovery post-COVID, the December 2023 Central Economic Work Conference (CEWC) clarified that development and security should be "balanced dynamically" [动态平衡] to ensure a "positive interaction [良性互动] between 'high-quality development' and 'high-level security'".[96&97] This seemed to be a toning down of security priorities in industrial policymaking compared to previous years. Second, two *People's Daily* op-eds in February 2024 put forward the idea that development and security should be balanced in practice, and how the pursuit of security needs at the expense of development interests should be avoided.[98] These were likely aimed at guiding local government officials to implement policies more effectively.

However, it is important to keep a close eye on how China's risk management continues to unfold, in terms of: 1) to what extent factors like China's economic slowdown or significant geopolitical developments will affect policy implementation and any resulting discriminatory impacts on European business; and 2) whether China's comprehensive top-down approach will lead to an overshoot of policy implementation.

Evolution of risk perception and risk management

Whereas integration with the global economy was once viewed as of paramount importance, it is now perceived to be riddled with risks that need to be carefully managed to ensure China's continued development. China's risk management can be broken down into four broad stages, from 1992 to 2023.

Phase 1 (1992–2005): A favourable external environment for China's development

In the build-up to and immediately after China's WTO accession in 2001, the country's leadership perceived a generally favourable external environment. Concerns focused on external financial shocks, like the Asian Financial Crisis in 1997, as well as on 'traditional' security issues including sovereignty, territorial integrity and international disarmament. Policies geared towards increasing economic resilience were still largely absent from policy-thinking, as the country embarked on a sweeping programme of liberal economic reforms in the 1990s and early 2000s.[99]

Nonetheless, a few initial ideas on managing economic interdependence emerged during this period, with the most notable being the concept of promoting the "independent and indigenous" [独 立 自 主] development of Chinese technology, as well as calls for import diversification of critical raw materials and resources. Initial ambitions and resources committed were limited.[100]

Phase 2 (2005–2011): A negative 'turn' to a more challenging external environment

Since the mid-2000s, China's leadership felt that the external environment had become more challenging. The global economy faced economic headwinds, and many nations began to take protectionist measures, posing a threat to

96 *The Central Economic Work Conference held in Beijing, Xi Jinping delivers an important speech, Xinhua*, 12th December 2023, viewed 12th January 2024, <http://www.news.cn/politics/leaders/2023-12/12/c_1130022917.htm>

97 In the newly articulated risk management policy formula, adjectives are added ahead of 'development', 'security' and 'balance', which is a method usually used to confine the scope of the policy concepts (for instance, comparing with the normal 'development' concept, 'high-quality development' emphasises a more value-added, efficient, and sustainable development model). This seems an implicit signal that the previous trade-off formula of "coordinate development and security" has been refined to avoid an excessive emphasis on security.

98 Zhong, Caiwen, *The pursuit of high-quality development must be regarded as the unswerving principle of the new era, People's Daily,* 29th January 2024, viewed 8th February 2024, <http://paper.people.com.cn/rmrb/html/2024-01/29/nw.D110000renmrb_20240129_2-02.htm?utm_content=280832858&utm_medium=social&utm_source=linkedin&hss_channel=lis-X8WxUavL8e>; Zhong, C., *It is necessary to adhere to high-quality development and high-level safe and constructive interaction, People's Daily*, 1st February 2024, viewed 8th February 2024, <http://paper.people.com.cn/rmrb/html/2024-02/01/nw.D110000renmrb_20240201_2-02.htm?utm_content=280832858&utm_medium=social&utm_source=linkedin&hss_channel=lis-X8WxUavL8e>

99 In the build-up to China's accession to the WTO in 2001, the country abolished, revised or introduced more than 2,300 national laws and nearly 200,000 local regulations, which led to further market opening. See: *China and the World Trade Organization*, State Council Information Office of the People's Republic of China, 28th June 2018, viewed 25th July 2022, <https://english.www.gov.cn/archive/white_paper/2018/06/28/content_281476201898696.htm>

100 For instance, China's 10FYP (2001–2005) only called for the country to "achieve diversification of import sources for oils, key commodities and key resources," which is far narrower in scope than later initiatives geared towards promoting a high degree of self-reliance.

China's export-orientated development model.[101]

China's risk management approach was deepened in 2006, with the release of an industrial policy aimed at developing domestic capacity in key technologies and industries, in order to move China further up global value chains (GVCs) and reduce its reliance on third markets. The State Council's National Medium- and Long-term Plan for the Development of Science and Technology (2006–2020) (MLP) included "indigenous innovation" targets and aimed to "reduce [China's] dependence on foreign technology by at least 30 per cent".[102] The plan was later supplemented by the Strategic Emerging Industries (SEI) initiative (2010), which explicitly outlined China's ambitions to 'leapfrog' in key technology areas.[103] Previous initiatives, including the country's prior focus on import diversification, were also broadened to include new areas such as food security,[104] advanced technology and raw materials.[105]

Phase 3 (2011–2020): Heightened risk perception and a holistic national security framework

Risk perception intensified from 2011 onwards, as growing instability, uncertainty and more "global problems" [全球性问题] solidified a view within the CCP that "[the] development opportunities and challenges China is facing are unprecedented, and [that] it is necessary to improve the [country's] ability to resist international economic risks."[106] This notion became more visible in Chinese policy discourse, as demonstrated by a sharp rise in the usage of terms such as 'risk' and 'security' in China's FYPs (Figure 3).

In 2012, at the 18th Party Congress, the newly coined terms "existential security" and "developmental security" reflected the greater urgency attached to security overall.[107] At the first session of the 18th National Security Commission in 2014, the need for a "holistic view of national security" was announced. This new approach—later incorporated into the CCP's constitution—extended the scope of national security to cover 16 distinct security concepts in 2018,[108] including seven that have more direct relevance for business (see Appendix C).

Accordingly, this period saw new policies introduced, with a particular focus on greater economic resilience. Growing ever warier of its overreliance on Western technology, in 2015, China launched its flagship China Manufacturing 2025 (CM2025) plan, with the aspiration of becoming internationally competitive in strategic industries explicitly framed as a means to ensure both China's "composite national strength" and its national security. Building on the SEIs, CM2025 details China's plans to increase its competitiveness across ten critical sectors,[109] assigning global "market share targets" and outlining the need for China to reduce its dependence on foreign core technologies.[110]

101 The GFC also coincided with a rise in economic protectionism globally, as governments introduced industrial policy measures to bolster both their domestic industrial competitiveness and position in global value chains, in response to the ensuing global economic downturn. Since 2008, 110 countries– responsible for 90 per cent of the global economy–have adopted some form of industrial policy measures according to the United Nations Conference on Trade and Development (UNCTAD). *World Investment Report 2020*, UNCTAD, 16th June 2020, viewed 26th December 2023, <https://unctad.org/publication/world-investment-report-2020>

102 McGregor, James, *China's Drive for 'Indigenous Innovation', A Web of Industrial Policies*, US Chamber of Commerce, p. 4, 2010, viewed 4th July 2023, <https://www.uschamber.com/assets/archived/images/legacy/reports/100728chinareport_0.pdf>

103 The 2010 Strategic Emerging Industries (SEI) initiative, which reiterated the guiding principles of the MLP, was aimed at supporting hand-picked national champions to become leaders in strategic industries. For a summary of the evolution of Chinese industrial policy over this period, see: Naughton, Barry, *The rise of China's industrial policy, 1978 to 2020*. México: Universidad Nacional Autónomica de México, Facultad de Economía, 2021.

104 For instance, China's 11FYP noted the need "to enhance the capacity to ensure food security.": *11th Five-year Plan for Economic and Social Development of the People's Republic of China,* State Council, 14th March 2006, viewed 1st December 2023, <https://www.gov.cn/gongbao/content/2006/content_268766.htm>

105 China's 11FYP also noted the need for China to, "expand the import of advanced technology, key equipment and components, and raw materials that are in short supply domestically", *11th Five-year Plan for Economic and Social Development of the People's Republic of China*, State Council, 14th March 2006, viewed 1st December 2023, <http://www.npc.gov.cn/zgrdw/npc/xinwen/jdgz/bgjy/2006-03/18/content_347869.htm>

106 Jintao, Hu, *Report to the 18th National Congress of the Communist Party of China, People's Daily*, 8th November 2012, viewed 1st December 2023, <http://politics.people.com.cn/n/2012/1118/c1001-19612670-1.html>

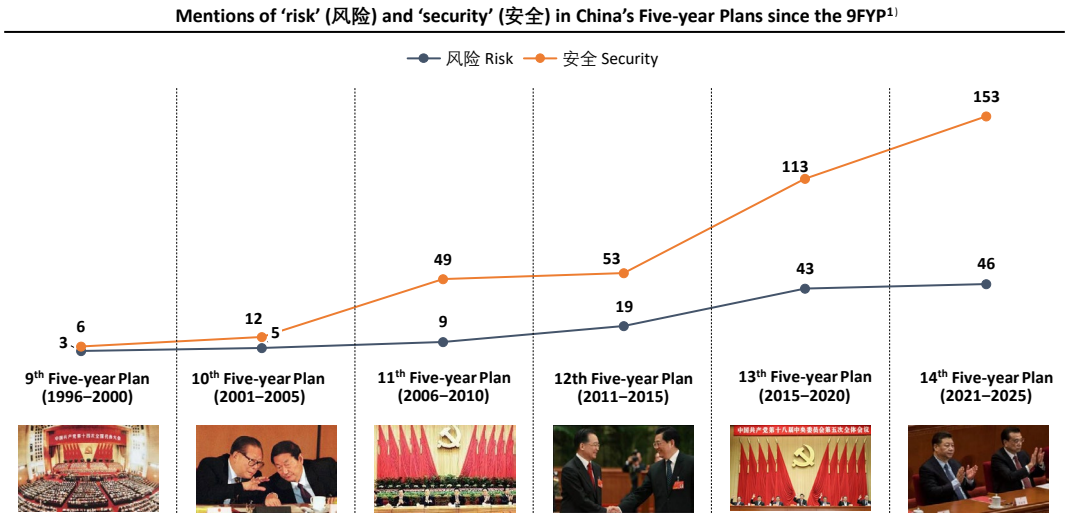
107 *Report of 18th Party Congress*, 17th November 2012, viewed 11th November 2023, State Council, <https://www.gov.cn/ldhd/2012-11/17/content_2268826.htm>

108 The 16 security concepts are: political security, military security, territorial security, economic security, cultural security, biological security, cybersecurity, societal security, technological security, ecological security, resource security, nuclear security, overseas interests security, outer space security, deep sea security and polar security.

109 The ten sectors identified in the plan are: robotics, new generation information technology, aviation and aerospace equipment, maritime equipment and high-technology ships, railway transport, new energy and energy-saving vehicles, energy equipment, agricultural equipment, new materials, biopharma, and high-technology medical devices.

110 As outlined in the European Chamber's report *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces*, at its core the policy was "a large-scale import substitution plan aimed at nationalising key industries, or at least curtailing the position of foreign business in them, both as suppliers of key components and finished products." See: *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces*, European Union Chamber of Commerce in China, 2017, <https://www.europeanchamber.com.cn/en/china-manufacturing-2025>

Figure 3: China's risk perception and security needs have both consistently grown over the past three decades



Given the strongest non-linear rise of security needs relative to risk perception, the 14FYP marks a step-change in security-orientated policymaking

1) Note: only 'risk' and 'security' used in the context of national security / economic security are counted; it excludes mentions in the context of 'safety', e.g., 'production safety'

Source: China's 9FYP—14FYP

China's 13FYP (2016–2020) was the first FYP since 1953 that included a dedicated sub-chapter on national security. It also reiterated some policy priorities, for instance calling for the country to advance its indigenous technological capabilities. This included the independent design and systemic integration of high-end equipment, and establishing overseas production bases and cooperation zones to ensure the supply of key commodities.[111]

Phase 4 (2020–ongoing): Top-down risk management due to acute and broad risk perception

The view among some of China's leaders that access to Western technology and markets would be curbed was vindicated in the late 2010s, after the US, under President Trump, started adopting a more hawkish stance towards the PRC.

The US-China trade war,[112] and restrictions imposed on Chinese national champions such as ZTE and Huawei, highlighted that market access could and would be restricted by the US at both the macro- and firm-levels.[113&114]

111 *13th Five-year Plan for Economic and Social Development of the People's Republic of China,* State Council, 17th March 2016, viewed 21st December, <https://www.gov.cn/xinwen/2016-03/17/content_5054992.htm>

112 After conducting an investigation under Section 301 of the Trade Act of 1974, the Trump administration began imposing 25 per cent tariffs on Chinese imports worth roughly USD 34 billion in July 2018, and an additional number of imports worth USD 16 billion in August 2018. After China took retaliatory actions, 10 per cent tariffs were imposed by the US on an additional USD 200 billion of imports in September 2018, with this duty increased by 25 per cent in June 2019. A further USD 102 billion worth of Chinese imports were hit with 15 per cent tariffs in September 2019. Bown, Chad, *Four Years into the Trade War, are the US and China Decoupling?*, Peterson Institute for International Economics, 20th October 2022, viewed 24th December 2023, <https://www.piie.com/blogs/realtime-economics/four-years-trade-war-are-us-and-china-decoupling>

113 In March 2021, the Secure and Trusted Communications Network Act established a list of entities whose equipment is not allowed to be sold to the US. The list initially only contained five companies—Huawei, ZTE, Hytera, Hikvision, and Dahua—but was further expanded in March 2022 to include Kaspersky Lab, China Mobile and China Telecom, and then again in September 2022 to include Pacific Networks and China Unicom. *Public Safety and Homeland Security Bureau Announces Additions to the List of Equipment and Services Covered by Section 2 of the Secure Networks Act,* FCC, 20th September 2022, viewed 13th December 2023, <https://docs.fcc.gov/public/attachments/DA-22-979A1.pdf>

114 As of June 2023, 10 EU Member States had restrictions on the use of Huawei technology in their 5G networks. Brown, Ryan, *EU urges more countries to ban China's Huawei, ZTE from 5G networks, CNBC*, 21st June 2023, viewed 25th December 2023, <https://www.cnbc.com/2023/06/16/eu-urges-more-countries-to-ban-chinas-huawei-zte-from-5g-networks.html>

China's ability to acquire technology for its own industrial upgrading and development was also called into question. Extensive restrictions on Chinese investments into key markets such as the US—where annual investments fell by 97 per cent between 2017 and 2022—made it clear that acquiring strategic technologies was not a viable long-term strategy.[115] Export controls aimed at hindering the flow of key technologies from West to East—most notably on advanced semiconductor technology—compounded this issue.[116]

As previously mentioned, increased urgency was placed on risk management and with the 14FYP the Chinese Government formalised the concept "coordinate development and security" in response, placing it at the top level of China's policy hierarchy as one element of the dual circulation policy. This means that all sixteen security concepts can be balanced against development interests, effectively creating a comprehensive scope for security-orientated policymaking.[117&118] This new top-level policy was henceforth integrated as a principle into all key policy documents.[119]

The evolution of China's role in global value chains

Following its accession to the WTO, China quickly found itself at the centre of GVCs.[120&121] Although it has maintained this position, its role in GVCs has evolved, becoming increasingly asymmetric over a time period that correlates with the convergence of security and development concerns in Chinese policies, as the country pursued its goals of catching up in key technologies and industries, and becoming more self-reliant while creating dependencies on its own market.

A country's involvement in GVCs can be broken down into: 1) forward participation – the production and export of intermediate goods that are sent to third markets to form parts of its finished goods for export; and 2) backward participation – the use of imported intermediate goods from overseas to produce finished goods that are then exported abroad.[122]

Figures 4 and 5 show how the backward and forward participation in GVCs of China, the euro area and the US changed from 2005 to 2022, as measured as a percentage of their total gross exports. China is unique in that its forward participation increased sharply (from 24 to 37 per cent), while its backward participation decreased (from 17 to 11 per cent). This indicates that China has been successful in simultaneously increasing other countries' dependence on its intermediates while decreasing its dependencies on inputs from third markets.

115 This drop in investment occurred following the expansion of the US Committee on Foreign Investment in the United States (CFIUS), the US Government body responsible for screening and approving investment into the US: *Data on new foreign direct investment in the United States*, US Bureau of Economic Analysis, viewed 24th December 2023, <https://apps.bea.gov/iTable/?reqid=2&step=1&isuri=1#eyJhcHBpZCI6Miwic3RlcHMiOlsxLDIsMyw0LDUsNywxMCwxMF0sImRhdGEiOltbIlN0ZXAxUHJvbXB0MSIsIjliXSxbIlN0ZXAxUHJvbXB0MiIsIjMiXSxbIlN0ZXAyUHJvbXB0MyIsIjEiXSxbIlN0ZXAzUHJvbXB0NCIsIjYyIl0sWyJTdGVwNFByb21wdDUiLCIyNS>

116 On 7th October 2022, the US Department of Commerce's Bureau of Industry and Security (BIS) issued landmark export controls on semiconductors and chip-making equipment effectively kneecapping China's semiconductor production capability in key technology 'chokepoints'. In 2023, the Netherlands and Japan adopted similar export controls. Jie, Yu, *China's new scientists: The emerging leaders behind China's drive for technological self-reliance*, Chatham House, 24th July 2023, viewed 14th December 2023, <https://www.chathamhouse.org/2023/07/chinas-new-scientists/breaking-chinas-technological-chokepoints>

117 For instance, China's 14FYP called for policymakers to, "ensure security and controllability in key areas such as important industries, infrastructure, strategic resources." *14th Five-year Plan for Economic and Social Development of the People's Republic of China*, State Council, 13th March 2021, viewed 21st December 2023, <https://www.gov.cn/xinwen/2021-03/13/content_5592681.htm>

118 For instance, China's 20th Party Congress report noted the need to "devote efforts to enhance the resilience and security of industrial and supply chains," Jinping, Xi, *Report to the 20th National Congress of the Communist Party of China*, 16th October 2022, viewed 21st December 2023, <https://www.gov.cn/xinwen/2022-10/25/content_5721685.htm>

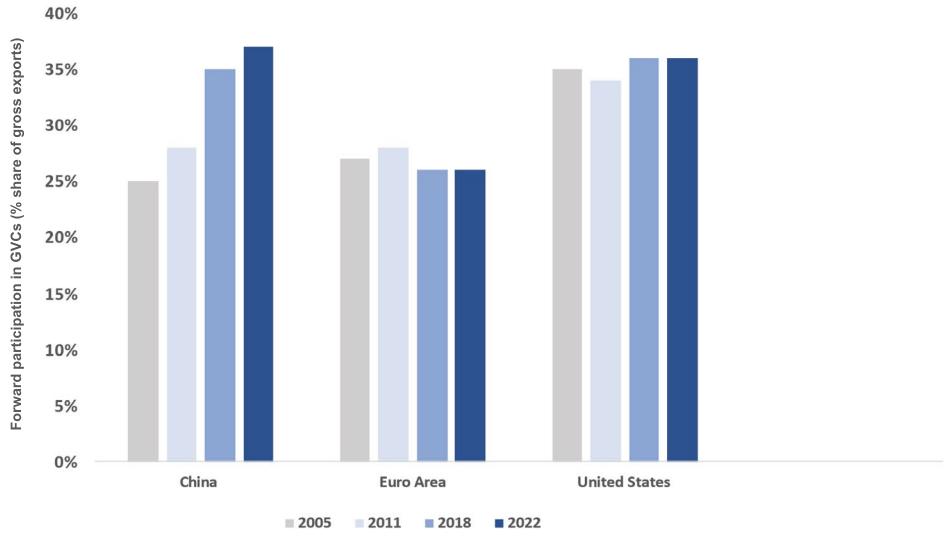
119 This principle has since featured in announcements of the CEWC, China's top-level annual meeting arranging economic and financial affairs, as well as in industrial policies such as China's sectoral 14FYPs.

120 Today, the production of many goods is a global endeavour with various processes, including different stages of manufacturing and assembly, taking place across multiple countries, with each step in the process adding value to the end product. 'GVCs' encapsulates this process, namely the fragmentation of the production of goods across global multinational networks.

121 For a comprehensive summary of GVCs and how they have been influenced by China's economic rise, see: García-Herrero, Alicia, *Resilience of Global Supply Chain: Facts and Implications*, Asian Development Bank Institute, June 2023, viewed 28th January 2024, <https://www.adb.org/publications/resilience-of-global-supply-chain-facts-and-implications>

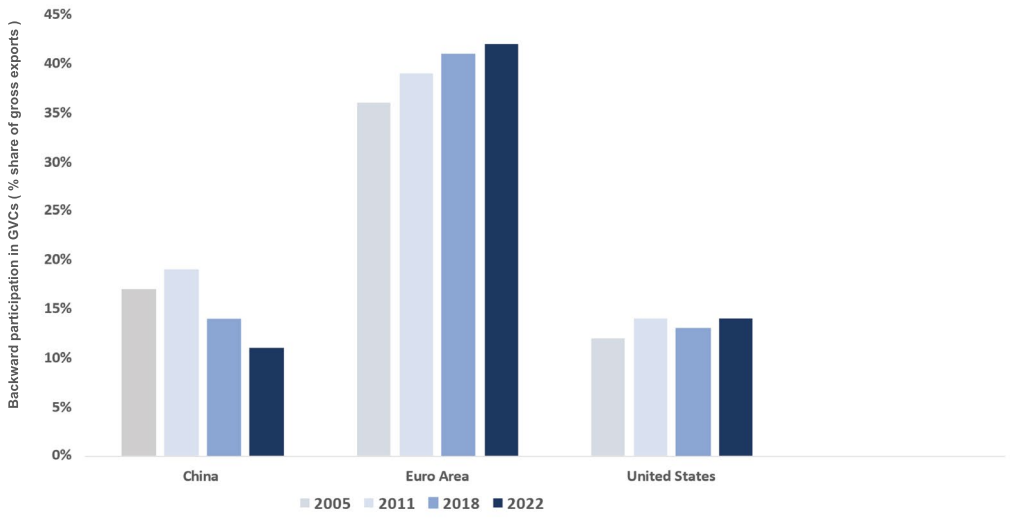
122 To illustrate this, take the production of a phone. Its battery may be produced in South Korea, its screen in Japan and the rest of its electronics in China. These respective parts may be exported to Vietnam to be put in a case before being exported onto Brazil as a finished product. In this example, the exporting of the electronics, battery and screen represent examples of *forward participation* in GVCs, while the final assembly and export of the phone from Vietnam is an example of *backward participation*.

Figure 4: Global GVCs become more reliant on Chinese inputs; reliance on euro area and US remains consistent (2005–2022)



Source: UNCTAD-Eora database

Figure 5: China's reliance on GVCs for inputs decreases; rises for euro area and US (2005–2022)



Source: UNCTAD-Eora database

Policy implementation of China's 'coordinate development and security' concept

Under the 14FYP, China's risk management policies that are most relevant to foreign business are implemented by seven central government ministries plus the Cyberspace Administration of China (CAC), an organ directly supervised by the CCP Central Committee. The most important state organs for risk management are the State Council, the National Development and Reform Commission (NDRC), the Ministry of Science and Technology (MOST), the Ministry of Industry and Information Technology (MIIT), and the Ministry of Commerce (MOFCOM), whereas the Ministry of State Security (MSS) and the Ministry of Transport (MOT) are less active.

Figure 6: Chinese government agencies implementing risk management measures under the "holistic view of national security" framework

Party organ / State organ		*Cyberspace Administration of China (CAC)*	*State Council*	*National Development and Reform Commission (NDRC)*	*Ministry of Industry and Information Technology (MIIT)*	*Ministry of Commerce (MOFCOM)*	*Ministry of Science and Technology (MOST)*	*Ministry of State Security (MSS)*	*Ministry of Transport (MOT)*
Key business-relevant security concepts	Economic security		✓	✓	✓	✓			
	Biological security		✓	✓			✓		
	Cybersecurity	✓	✓	✓					
	Resource security		✓	✓					
	S&T security						✓		
	Political security							✓	
	Territorial security								✓
Key risk management measures by 'type'	*Self-reliance*		✓	✓	✓				✓
	Tech 'breakthroughs'				✓		✓		
	Securing external supply		✓	✓	✓				
	Building 'trump cards'			✓	✓				
	Sectoral governance	✓	✓						
	Retaliatory capacity		✓			✓		✓	
Observed depth of measures		◕	◕	◕	◑	◑	◕	◔	◔

Source: State Council Policy Database

Chinese policymakers have introduced a slew of risk management measures over time, building up a toolkit geared towards enhancing the country's security. These measures are explicitly linked to one of the seven abovementioned security concepts, which are relevant for economic sectors and business,[123] and can be categorised into six 'types' as summarised below.[124]

As part of efforts to ensure China's security in an environment perceived as increasingly risky, the six 'measure types' that have been applied to economic sectors include: 1) enhancing China's self-reliance; 2) facilitating indigenous technological breakthroughs; 3) securing external supply; 4) building/leveraging 'trump card' technologies; 5) governing sensitive technology; and, more recently, 6) developing retaliatory capacity to limit the country's susceptibility to foreign pressure.

123 CMG conducted a textual analysis of policy reports issued by the seven central government ministries and the CAC. The State Council Policy Database was searched for seven business-relevant security concepts: 'economic security (as well as relevant terms e.g., supply-chain security and industrial security)', 'biological security', 'cybersecurity', 'resource security', 'S&T (science and technology) security', 'political security' and 'territorial (infrastructure) security'. Each corresponding hit was then individually screened to identify instances in which such terms had been used in the context of economic security.

124 Around 90 specific risk management measures have been identified for this report through extensive research of policy documents in the *State Council's Policy Database*. State Council's Policy Database, State Council, viewed 15th December 2023, <https://www.gov.cn/zhengce/zhengcewenjianku/>

Type 1: Enhancing self-reliance *(focus on supply of critical resources, components and goods)*

Steps have long been taken by China to mitigate risks associated with over-dependence on foreign supply chains. Following the global supply chain disruptions caused by the COVID-19 pandemic and the Russia-Ukraine war, China's need to ensure security and "controllability" in key supply chains intensified, especially targeting resources, components and goods that are critical to achieve China's aspirations for global industrial competitiveness.[125]

Throughout the years, trade, investment promotion and industrial policies backed by state-owned funds have been employed extensively to strengthen the country's industrial base and build highly integrated domestic industrial value chains. Building on that, efforts specifically aimed at enhancing supply chain security and resilience have been added in recent years, including the building of shorter and more concentrated supply chains around industrial cities.[126] Efforts have also been undertaken to expand domestic production and storage capacity for key resources such as energy, food and critical minerals in an attempt to mitigate potential supply shocks.[127&128]

In addition, policies have been used to incentivise foreign companies in strategic sectors operating in China to onshore and localise their production and key business functions, hence integrating them into China's domestic supply chain. Some public procurement guidelines tied to localised production, such as China's "autonomous and controllable" guidelines, have also been issued.[129]

Such guidelines encourage Chinese companies, especially in strategically important sectors, to avoid the use of foreign technology that the Chinese Government fears could be cut off by other countries, while pressuring or incentivising firms to preferentially use domestic Chinese suppliers. European Chamber members—including those that are already highly localised—have reported that this puts them at distinct disadvantage compared to their domestic competitors.[130&131] Selective market access that is dependent upon localised production or joint-venture requirements has also been applied in some areas.[132]

In some sectors deemed integral to China's national security, policymakers have gone a step further, issuing explicit directives to replace foreign components and technologies with domestic ones. For example, for IT hardware and

125 *14th Five-year Plan for Economic and Social Development of the People's Republic of China,* State Council, 13th March 2021, viewed 21st December 2023, <https://www.gov.cn/xinwen/2021-03/13/content_5592681.htm>

126 In 2022, the Ministry of Industry and Information Technology (MIIT) launched the first group of pilot programmes in 12 cities, with each building a collaborative network of companies across entire supply chains, in order to concentrate upstream suppliers and downstream finished good manufacturers within a shorter geographical distance. See: *MIIT launching the first group of pilot projects for supply-chain/industrial-chain ecosystem,* Ministry of Industry and Information Technology, 10th October 2022, viewed 15th October 2023, <https://www.miit.gov.cn/xwdt/gxdt/sjdt/art/2022/art_19594b875c90456dbaf098c792104dca.html>

127 One benchmark calls for Chinese producers to meet 95 per cent of the country's demand for basic grains, an area that has had mixed success. See: *When China worries about food, the world pays, The Economist,* 9th April 2022, viewed 23rd December 2023, <https://www.economist.com/china/2022/04/09/when-china-worries-about-food-the-world-pays>

128 China's effort to ensure energy security by increasing self-reliance and reducing import dependency has long existed, but the process was consistently slow and resulted in limited outcomes until recent years, when resource self-reliance began increasingly receiving high-level policy attention.

129 For instance, references to 'autonomous and controllable' guidelines feature in at least ten of China's sectoral 14FYP plans.

130 One example of this is when it comes to urban rail, an industry in which tenders are often based on a points system. Chinese wholly domestic-owned enterprises automatically receive one point, joint ventures (JVs) receive half a point and foreign enterprises receive zero points. This makes it difficult for European companies in the sector to win tenders, despite their China operations being long established and highly localised. Such restrictions have a substantial impact on business. The European *Chamber's Business Confidence Survey 2023* found that 62 per cent of all respondents in the sector missed out on business opportunities in China in 2023: *Rail Working Group Position Paper 2023/2024*, European Union Chamber of Commerce in China, pp. 246–247, 20th September 2023, viewed 25th December 2023, <https://europeanchamber.oss-cn-beijing.aliyuncs.com/upload/documents/documents/2023_Rail_working_group_%5b1132%5d.pdf>

131 22 per cent of respondents to the European Chamber's *Business Confidence Survey 2022* reported that they expect China's A&C guidelines to have a "somewhat negative impact" or "significant negative impact" on their business in China over the next five years. Unpublished statistic from: *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20st June 2022, viewed 24th December 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1020/Business_Confidence_Survey_2022>

132 One example of this is in the automotive sector in which until the end of 2021 the ability to invest in the sector was tied to requirements for foreign original equipment manufacturers (OEMs) to enter into JV partnerships. These restrictions were formally lifted on 1st January 2022, notably at a time when Chinese manufacturers had developed enough to be at the frontier of the technology curve, particularly in advanced technologies such as new energy vehicles (NEVs) and autonomous driving. Chamber member companies continue to face investment restrictions in practice due to informal guidance from the authorities, who require that any investment above 50 per cent ownership in a JV be approved. This gives authorities the discretion to block foreign investment on 'security grounds'. This was reported by several member companies in interviews for this report.

medical devices, procurement rules have been introduced that exclude foreign players.[133&134]

China has also sought to facilitate the development of its own domestic firms to fill critical gaps in supply chains and reduce its reliance on—or even replace—foreign companies, including through initiatives such as its 'hidden champions' policy.[135] This policy provides support such as subsidies, tax incentives and privileged market access to selected small- and medium-sized enterprises (SMEs). By the end of 2022, 8,997 domestic Chinese SMEs that lead in niche areas, had benefited from the initiative, predominantly in segments deemed strategic by China's state-planners.[136]

Type 2: Achieving "key/core technology breakthroughs" *(focus on bottleneck technologies)*

Beijing has set broad policy goals to catch up with indigenous solutions in technologies crucial for China's industrial ecosystems, and to mitigate the risk of supply shortages due to potential or already-materialised restricted access to crucial components and technologies from the West, such as semiconductors and advanced manufacturing equipment.

Particular attention has been paid to addressing so-called 'bottleneck' technologies that China imports from overseas. While 'key' and 'core' technologies have not been defined more precisely, Appendix D of this report provides a semi-official list of China's 35 key technologies—as identified by the Ministry of Science and Technology-owned media outlet *Science and Technology Daily*—which "have the potential to restrict China's industrial development" if access to those technologies were to be cut off by trade partners. A summary of the extent to which these technologies are subject to US policy tools is also included in Appendix D.

China's approach to tackling such technological bottlenecks is exemplified by the so-called "new system for mobilising resources nationwide" [新型举国体制], a concept introduced by Xi Jinping in 2021. This concept essentially introduces a top-down, state-led model to coordinate and concentrate efforts and resources across various industries and regions, to optimise the chances of achieving successful indigenous innovation and R&D outcomes in crucial technologies.[137]

The European Chamber has noted that while support for indigenous innovation and R&D activities in critical areas is something all main economies engage in, the Chinese "new system" provides extensive policy support in financial, material and knowledge resources that is not matched by others.

Taking semiconductor technology and fabrication as an example, analysis from the US Semiconductor Industry Association (SIA) highlights that from 2014 to 2021, China's state-backed National Integrated Circuits Industry Development Investment Fund and 15 local government funds collectively announced investments worth United States dollar (USD) 73 billion. Additional financing worth upwards of USD 50 billion was made available via Chinese government grants, equity investments and low investment loans.[138] By comparison, the US CHIPS and

133 One of the clearest examples of this is the 2019 '3-5-2' policy, which stipulated that the use of foreign IT hardware and software should be reduced in Chinese government offices by 30 per cent by 2021, a further 50 per cent by 2023, and the remaining 20 per cent by 2025. Liu, Nian & Yang, Yuan, *Beijing orders state offices to replace foreign PCs and hardware, Financial Times*, 9th December 2019, viewed 23rd December 2023, <https://www.ft.com/content/b55fc6ee-1787-11ea-8d73-6303645ac406>

134 For example, in a notice published on 10th August 2021, China's Ministry of Finance stated that public hospitals carrying out procurement within their regular budget—whatever the source of the budget—must apply government procurement rules, implying that, in accordance with the Government Procurement Law, public hospitals must preferably buy medical devices manufactured in China. See: *Healthcare Equipment Working Group Position Paper 2022/2023*, European Union Chamber of Commerce in China, 21st September 2022, pp. 242–254, viewed 25th December 2023, <https://europeanchamber.oss-cn-beijing.aliyuncs.com/upload/documents/documents/European_Business_in_China_Position_Paper_2022_2023%5b1068%5d.pdf>

135 *Notice on the issuance of the "Requirements on demonstration of national supply chain innovation and application" by 8 entities including the Ministry of Commerce,* Ministry of Commerce, 5th May 2022, viewed 25th December 2023, <http://www.mofcom.gov.cn/article/zcfb/zcgnmy/202207/20220703333196.shtml>

136 The overwhelming majority of which occupy strategic emerging sectors such as the advanced equipment, advanced materials and ICT sectors; 89.9 per cent specialise in the manufacturing sector and 96 per cent focus on strategic emerging sectors including advanced equipment, advanced materials, and ICT. See: *The profile of China's "little giants" SMEs, People's Daily*, 28th September 2022, viewed 12th November 2023, <http://paper.people.com.cn/rmrbhwb/html/2022-09/28/content_25941974.htm>

137 *14th Five-year Plan for Economic and Social Development of the People's Republic of China,* State Council, 13th March 2021, viewed 21st December 2023, <https://www.gov.cn/xinwen/2021-03/13/content_5592681.htm>

138 *Taking Stock of China's Semiconductor Industry,* Semiconductor Industry Association, 13th July 2021, viewed 21st December 2023, <https://www.semiconductors.org/taking-stock-of-chinas-semiconductor-industry/>

Science Act and the European CHIPS Act have earmarked USD 52.7 billion and euro (EUR) 15.8 billion in support respectively.[139&140]

Type 3: Securing overseas supplies

China cannot completely remove its dependency on external sources by building and strengthening local supply chains and facilitating the technological upgrading of its domestic firms. There are still certain goods and components from overseas that it needs, something made clear by China's experience during the COVID-19 pandemic and following Russia's invasion of Ukraine.[141&142] An emphasis has therefore been placed on securing external sources of critical natural resources, such as crude oils, gas and iron ore, including through significant investments in mining and refining overseas, sometimes via the Belt and Road Initiative.

According to the Green Finance and Development Centre of Fudan University, overseas Chinese investments and new contracts in the mining and metals sector alone topped USD 10 billion during the first half of 2023,[143] while Chinese investors now dominate the mining sectors in a number of resource-rich states in Africa and Latin America.[144] Efforts have also been undertaken to promote the diversification of physical transportation routes for key resources, in large part to mitigate the risk of any adverse impacts on potential chokepoints such as the Strait of Malacca.[145]

Type 4: Building 'trump cards' *(for both mature and strategic emerging technologies)*

The Chinese Government has identified both mature technologies in which China already holds an advantage, as well as strategic emerging technologies for which it supports domestic companies in becoming global leaders. Importantly, the stated goal is not only to become a global leader for the sake of China's economic development, but also to increase global supply chains' reliance on Chinese technology, in an attempt to strengthen China's geoeconomic leverage.[146]

As part of this plan, Chinese policymakers aim to facilitate further upgrading of China's mature technologies, such as high-speed rail, power plants, new energy and communication equipment.[147] For example, China's *14FYP for Railway Technology Innovation* is aimed at further upgrading China's high-speed rail technology regarding speed, safety, digitalisation and decarbonisation.[148] The aim is to become a "global innovation hub and talent centre for railway technology", and to increase "China's influence in global railway innovation and institutional setting" by 2035.

139 *Fact Sheet: CHIPS and Science Act Will Lower Costs, Create Jobs, Strengthen Supply Chains, and Counter China*, The White House, 9th August 2022, viewed 31st December 2023, <https://www.whitehouse.gov/briefing-room/statements-releases/2022/08/09/fact-sheet-chips-and-science-act-will-lower-costs-create-jobs-strengthen-supply-chains-and-counter-china/>

140 *European Chips Act,* European Commission, viewed 31st December 2023, <https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/europe-fit-digital-age/european-chips-act_en>

141 An April 2022 flash survey conducted by the European Chamber showed that Russia's invasion of Ukraine and the Spring 2022 COVID-19 lockdown of Shanghai had a negative impact on 65 per cent and 92 per cent of respondents' supply chains respectively. *Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China,* European Union Chamber of Commerce in China, 5th May 2022, viewed 25th December 2023, <https://europeanchamber.oss-cn-beijing.aliyuncs.com/upload/documents/documents/European_Business_in_China_Executive_Position_Paper_2022_2023[1067].pdf>

142 The Strait of Malacca is a narrow waterway, close to Singapore, connecting the Indian Ocean with the Pacific Ocean through the South China Sea, which plays a pivotal role in global maritime trade. Dependence on trade passing through the Strait has been recognised as a vulnerability for China by the CCP's leadership since at least 2003. See: *How much trade transits the South China Sea*, CSIS: China Power, 2nd August 2017, viewed 24th December 2023, <https://chinapower.csis.org/much-trade-transits-south-china-sea/>; Mendis, Patric & Wang, Joey, *From Taiwan to the Belt and Road, China's Grand Plan is to Push the US out of Asia, South China Morning Post,* 23rd January 2019, viewed 24th December 2023, <https://www.scmp.com/comment/insight-opinion/united-states/article/2183127/taiwan-belt-and-road-chinas-grand-plan-push-us>

143 Wang, Chirstopher, *China Belt and Road (BRI) Investment Report 2023 H1*, The Green Finance and Development Center, 1st August 2023, viewed 22nd December 2023, <https://greenfdc.org/china-belt-and-road-initiative-bri-investment-report-2023-h1/>

144 For instance, Chinese investors accounted for close to 70 per cent of the total stock of FDI in the Democratic Republic of the Congo's mining sector, as of 2020. Ross, Aaron & Strochecker, Karin, *Congo reviewing six billion mining deal with Chinese investor – Finance Minister, Reuters*, 28th August 2021, viewed 25th December 2023, <https://www.reuters.com/article/us-congo-mining-exclusive-idINKBN2FS11M/>

145 One manifestation of this has been the construction of alternative channels and networks for crude oil imports, including routes in Pakistan-Southwest China, Central Asia-Northwest China, and Russia-Northeast China.

146 Jinping, Xi, *Major Issues Concerning China's Strategies for Mid-to-Long-Term Economic and Social Development, QS Theory,* 31st October 2020, viewed 25th December 2023, <http://www.qstheory.cn/dukan/qs/2020-10/31/c_1126680390.htm>

147 Ibid.

148 Part III, *14th FYP for Railway Technology Innovation*, National Railway Administration, 14th December 2021, viewed 4th January 2024, <https://www.gov.cn/zhengce/zhengceku/2021-12/24/content_5664357.htm >

As an early example, the Ministry of Science and Technology (MOST) together with China's biggest SOE in rolling stock manufacturing, the China Railway Rolling Stock Corporation (CRRC), launched an R&D programme to manufacture a globally-leading, high-speed train with a speed of 400 kilometres per hour. The train is specially designed for international routes and allows operation under different climate conditions, track gauges and power supply standards. The prototype was made in 2020, and a series of subsequent on-rail experiments have been conducted. According to the CRRC, the newly developed train potentially fits 90 per cent of the global railway network and will allow Chinese technology and standards to compete globally.[149]

In addition to high-speed rail, China has also been coordinating its R&D resources to support the development of domestic firms in other strategic industries, by establishing national laboratories and organising government-supported research projects. These industries include AI, gene technology, hydrogen energy and quantum computing.[150&151]

Following on from the release of the national 14FYP, which explicitly listed the development of quantum technology as a priority, at least 21 provincial FYPs were released detailing plans to support basic research and experimental applications of quantum technologies at the local level.[152]

Type 5: Tightening sectoral governance *(focus on sensitive technology)*

To mitigate risks associated with the potential abuse or weaponisation of sensitive technologies, China has tightened sectoral governance. This has so far been most prominent in the field of cybersecurity and biosecurity, which is a key requirement for developing the bioeconomy.[153]

For cybersecurity, stringent data regulations have been introduced to reduce the exposure of sensitive areas—such as government infrastructure, public transportation and the financial system—to cyber-related risks. A cybersecurity system has been established, which reviews and assesses the security of software and hardware use, and compliance requirements for cross-border data transmission have been strengthened according to guidelines and standards set by the Cybersecurity Law and other CAC regulations.[154&155] China is also promoting the protection of key information and communication technology (ICT) infrastructure used in critical sectors through cross-sector policy guidance, which it further detailed in a series of sectoral regulations.

One of the most commonly implemented measures to mitigate risks has been security reviews on products or services intended for use in critical ICT infrastructure.[156] Since 2021, for instance, companies providing such products and services—including servers, storage devices, databases and cloud computing services used in information infrastructure sectors such as telecommunications, government and transportation—have been obligated to complete

149 *The production of a high-speed cross-border high-speed train with a speed of 400 km/h*, CRRC, 22nd October 2020, viewed 4th January 2024, see: <https://www.crrcgc.cc/zl/g22460/s26352/t315451.aspx>

150 *14th Five-year Plan for Economic and Social Development of the People's Republic of China*, State Council, 13th March 2021, viewed 21st December 2023, <https://www.gov.cn/xinwen/2021-03/13/content_5592681.htm>

151 Jinping, Xi, *Major Issues Concerning China's Strategies for Mid-to-Long-Term Economic and Social Development*, QS Theory, 31st October 2020, viewed 25th December 2023, <http://www.qstheory.cn/dukan/qs/2020-10/31/c_1126680390.htm>

152 In terms of the level of support provided, the effort of most note so far has been the attempt to build-up the National Lab for Quantum Information Science within the Chinese Academy of Science (CAS) in Anhui, which is the world's largest quantum research facility. It was earmarked to receive CNY 7 billion in local government investment: Wu, Wanrong, *Anhui will become a global highland for quantum research, Xinhua,* 25th October 2017, viewed 28th December 2023, <http://m.xinhuanet.com/ah/2017-10/25/c_1121851290.htm>

153 *14th Five-year Plan for Development of the Bioeconomy,* National Development and Reform Commission, 20th December 2021, viewed 30th December 2023, <https://www.ndrc.gov.cn/xxgk/zcfb/ghwb/202205/P020220510324220702505.pdf>

154 *The Decision to Amend the Cybersecurity Law (Draft for Comments),* CAC, 14th September 2022, viewed 18th September 2023, <https://www.gov.cn/xinwen/2022-09/14/content_5709805.htm>

155 For a summary of recent changes to China's data security regulations and their impact on European businesses operating in China, see: *European Chamber Flash Survey: The Impact of China's Data Regulations on European Business,* 14th November 2023, viewed 1st January 2023, <European_Chamber_Flash_Survey_EN_final[1170].pdf (aliyuncs.com)>

156 *Regulations on Security Protection of Critical Information Infrastructure,* State Council, 30th July 2021, viewed 10th October 2023, <https://www.gov.cn/zhengce/zhengceku/2021-08/17/content_5631671.htm?eqid=ae7a14dd000146480000000264784838>

mandatory cybersecurity reviews.[157]

For biosecurity, more stringent regulatory requirements are in place to ensure the safe development and use of biotechnology, the most important regulation for this being the *Regulations on the Safety Management of Biotechnology Research and Development.* This regulation established a national expert committee responsible for assessing the risk levels associated with biotechnology R&D. Any R&D activities classified as a mid- or high-risk level are required to be conducted only by Chinese entities, plus only under the direct supervision of regulatory authorities.

Type 6: Building retaliatory capacity *(focus on foreign influence/pressure)*

In addition to reducing the country's potential exposure to political actions by foreign countries, China's policymakers have recently begun developing legal tools to retaliate against foreign sanctions, perceived foreign interference and long-arm jurisdiction.[158] Such foreign-relations-related legislation accelerated since 2021. Key developments in this regard include the introduction of the Anti-Foreign Sanctions Law, the Foreign Relations Law and the amendments to the Anti-Espionage Law.[159]

While at the time of writing it remains to be seen how they will be implemented, all three contain vague and ambiguous references to the concept of 'national security'. This theoretically provides relevant authorities with a broad discretionary scope to crack down on anything viewed as not in their interests, both in retaliation and proactively for geopolitical reasons.[160]

While the process is still ongoing, China's new Export Control Law (ECL),[161] enacted with an explicit national security rationale, has had the biggest impact on economic sectors so far. Although lists of export controls on military and dual-use items have existed since the 1990s,[162] and export controls had already been imposed on rare earth elements (REEs) in 2010,[163] China's newly formalised legal framework for export controls was not in place until October 2020.

Compared to previous MOFCOM regulations and lists, the new law broadened the range of controlled items from highly sensitive items with weaponisation potential, to any items necessary to safeguard China's national security and national interests, including critical materials, critical goods, critical technology and critical technical data. In 2023, the MOFCOM used the revised law for the first time, introducing licensing requirements applicable to all China-based exporters of gallium and germanium, two minerals required in the production of semiconductors. This action is seen to have been taken in response to the US' deepening of semiconductor restrictions on China.

Following this, in October 2023, export restrictions on graphite—a material used in almost all electric car batteries, as well as semiconductors and nuclear reactors—were announced just three days after the US issued new controls aimed at restricting the export to China of chips required for AI.[164]

157 *No. 2023 of 2 on the Adjustment of the Catalogue of Critical Network Equipment and Special Products for Network Security,* CAC, 7th July 2023, viewed 27th December 2023, <https://www.gov.cn/zhengce/zhengceku/202307/content_6889847.htm>

158 China started from a very low base with hardly any such instruments in place prior to 2021. Then, Chairman of the Standing Committee of the National People's Congress (NPC), Li Zhanshu, urged the establishment of a comprehensive legal system to deal with foreign affairs. The focus was to be on enhancing the legal 'toolbox' for addressing challenges and mitigating risks generated by foreign sanctions, foreign interference and long-arm jurisdiction. Later, this was formalised as policy at the 20th Party Congress, within a new dedicated chapter on national security. *Report on the work of the Standing Committee of the National People's Congress*, State Council, 14th March 2022, viewed 24th December 2023, <https://www.gov.cn/xinwen/2022-03/14/content_5678947.htm>

159 The amended version of the Anti-espionage Law was approved by China's legislature on 26th April 2023 and came into effect on 1st July 2023, expanding the scope of activities that could be categorised as espionage. The Foreign Relations Law, adopted on 28th June 2023, puts an obligation on enterprises and citizens, among others, "to safeguard China's sovereignty, national security, dignity, honor and interests in the course of international exchanges and cooperation".

160 *Is doing business in China becoming impossible for foreigners?, The Economist,* 11th June 2023, viewed 25th December 2023, <https://www.economist.com/business/2023/06/11/is-doing-business-in-china-becoming-impossible-for-foreigners>

161 *Export Control Law 2020*, Ministry of Commerce, 30th December 2021, viewed 8th October 2023, <http://exportcontrol.mofcom.gov.cn/article/zcfg/gnzcfg/flfg/202111/226.html>

162 Six administrative regulations have been published since the 1990s for: 1) hazardous chemicals; 2) nuclear items; 3) military items; 4) dual-use nuclear items and technologies; 5) dual-use missile items and technologies; and (6) dual-use bio items and technologies.

163 *Ministry of Commerce Announcement on the 2010 Rare Earth Export Quota Declaration Conditions and Procedures*, Ministry of Commerce, 10th November 2009, viewed 7th February 2024, <https://www.gov.cn/gzdt/2009-11/10/content_1461303.htm>

164 Liu, Shiyi & Patton, Dominique, *China, world's top graphite producer, tightens exports of key battery material, Reuters,* 21st October 2023, viewed 25th December 2023, <https://www.reuters.com/world/china/china-require-export-permits-some-graphite-products-dec-1-2023-10-20/>

Figure 7: Overview of six key risk management 'measure types' 165

	1 Self-reliance	2 Key/core tech breakthroughs	3 Securing external supply	4 'Trump cards'	5 Sectoral governance (bio/cyber)	6 Retaliatory capacity
Addressed 'risk'	Import dependencies	China's tech "bottlenecks"	Import dependencies	Western tech decoupling	Weaponisation or abuse of sensitive tech	Inability to retaliate and deter
Area covered	Goods, components, resources	Tech	Resources (energy, food, critical minerals)	Tech (mature and emerging strategic tech)	Tech	Foreign influence and pressure
Risk management approach	Supply chain security via onshoring	Accelerated indigenous catch-up	Import diversification and 'going out'	Retain/create foreign dependencies on Chinese market	Market governance	Legal deterrence toolbox
Key policy areas	S&T / industrial / trade / investment promotion policy	S&T / industrial policy	Trade and foreign policy	S&T / industrial policy	Sector governance	Trade defence instruments and other laws
Economic sectors	Strategic and emerging	Strategic and emerging	Narrow	Strategic	Broad	Narrow
Impact on foreign business	●	◕	◔	◑	◕	◔

Building self-reliance, sectoral governance and tech breakthroughs as risk management with biggest impact on foreign business

Impact of risk management measures on European business

The abovementioned risk management measures can impact all market participants in China, however it is also possible to identify challenges that are specific to foreign and European businesses.

First, in view of China's risk management efforts of increasing self-reliance by building local industrial and supply chains, some foreign imports have been replaced by Chinese or China-based suppliers when local alternatives exist. For instance, some provinces and cities create incentives to localise supply chains by setting local content requirements in public procurement rules.[166]

Second, due to the tightened sectoral governance on sensitive data and biotechnology, foreign businesses producing or using relevant technologies and operating cross-border are under stricter regulation and scrutiny by Chinese authorities, including through licensing requirements and market access restrictions (e.g., to government clients).

ICT hardware and software providers, as well as information service providers, are subject to China's cybersecurity review framework, while a broader cross-sector impact on foreign business lies in cross-border data transfer, where more compliance efforts are needed to export important data, including certain R&D data and personal information.

Third, foreign businesses in China are more likely to be exposed to regulatory dilemmas caused by geopolitical tensions between China and the US. The build-up of China's comprehensive legal toolbox to retaliate against what it perceives to be foreign interference and long-arm jurisdiction allows the Chinese Government to sanction specific foreign companies or individuals and by doing so disrupt their China operations by, for instance, restricting their investment or market access to China.

165 Among these measures, there is a clear segmentation among policymakers to take responsibility for risk management with regard to specific security needs. Accordingly, each of the seven business-relevant security concepts has (a) major corresponding policymaker(s) in charge: political security – MSS; territorial security – MOT; economic security – NDRC, MIIT and MOFCOM; biosecurity – MOST; cybersecurity – CAC and NDRC; S&T security – MOST; resource security – State Council and NDRC.

166 *Three-year Action Plan to Strengthen Industrial Chain in Biopharmaceutical and Healthcare Sectors,* Suzhou Government, 21st March 2022, viewed 2nd February 2024, <https://www.suzhou.gov.cn/szsrmzf/dzlhfw/202203/21a1e3559cd84bf0b737f378b366d395/files/01663bdee9694054b9d3dac51d0299b0.pdf>

Fourth, foreign business can face discrimination through risk management-orientated industrial policies that provide financial support, networking, R&D cooperation or other privileged resources that are not equally available to foreign firms. This may be either formally or de facto—due to corporate culture, operating practices or simply a lack of understanding of the external environment—and applies particularly to industrial policies related to 'trump cards', technology 'breakthroughs' or broader self-reliance efforts.

However, it is notable that China's risk management efforts do not formally exclude foreign business from engaging in the Chinese market. As such, self-reliance does not discriminate against foreign companies as long as they are filling crucial gaps in domestic supply chains. For instance, foreign investment into bottleneck technologies and strategic emerging technologies is included in China's FDI positive list, while localisation of foreign businesses' supply chains and R&D activities—especially in high-technology sectors—can receive policy support including subsidies, tax incentives and privileged land-use.

Following China's re-opening after three years of stringent zero-COVID restrictions, which severely eroded sentiment in the market,[167] Chinese officials have signalled their intent to restore business confidence. The most noteworthy policy in this regard is the State Council's *Opinions of the State Council on Further Optimising the Foreign Investment Environment and Increasing Efforts to Attract Foreign Investment* (*Opinions*), issued on 13th August 2023, which include 24 points geared towards improving the business environment for foreign companies.[168] At the time of writing, it remains to be seen whether all of these measures will be fully implemented, as well as how China will balance them against its security concerns.

The view from the sectoral-level: no 'one size fits all' approach

To understand the implementation of risk management policymaking in China's economic sectors, 37 dedicated sectoral 14FYPs (2021–2025) have been analysed.[169] These sectors have been categorised in a matrix, considering the depth of China's risk management efforts for each sector (x-axis) and China's respective development ambition (y-axis). The matrix placement is also dynamic, therefore the ambition to lead globally can be elevated once international industrial competitiveness is achieved.

Key characteristics of the different clusters in the sectoral matrix:

- **Strengthen industrial competitiveness:** This is a cluster in which China has shown little risk management effort. Regardless of its industrial development ambitions in the FYPs, industrial instruments adopted for the industries within this cluster are focussed on strengthening China's own industrial competitiveness. None of the six risk management measures have been identified in the respective FYPs.
- **Cybersecurity governance:** Although the industries in this cluster have different industrial development ambitions, one common risk management measure—cybersecurity governance—has been identified in the instruments adopted by the respective industrial FYPs. This reflects the comprehensive implementation of cybersecurity regulations across many sectors.
- **Cultivate emerging industries indigenously:** For industries within this cluster, China has not showed global leadership ambitions, rather only plans to enhance global market share or promote domestic development for now. Nonetheless, China has adopted broad risk management measures, notably achieving technology breakthroughs,

167 The European Chamber's *Business Confidence Survey 2023* reported that business confidence had dropped to the lowest levels on record, based on a number of metrics. *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p.28, 21st June 2023, viewed 21st December 2023, <https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>

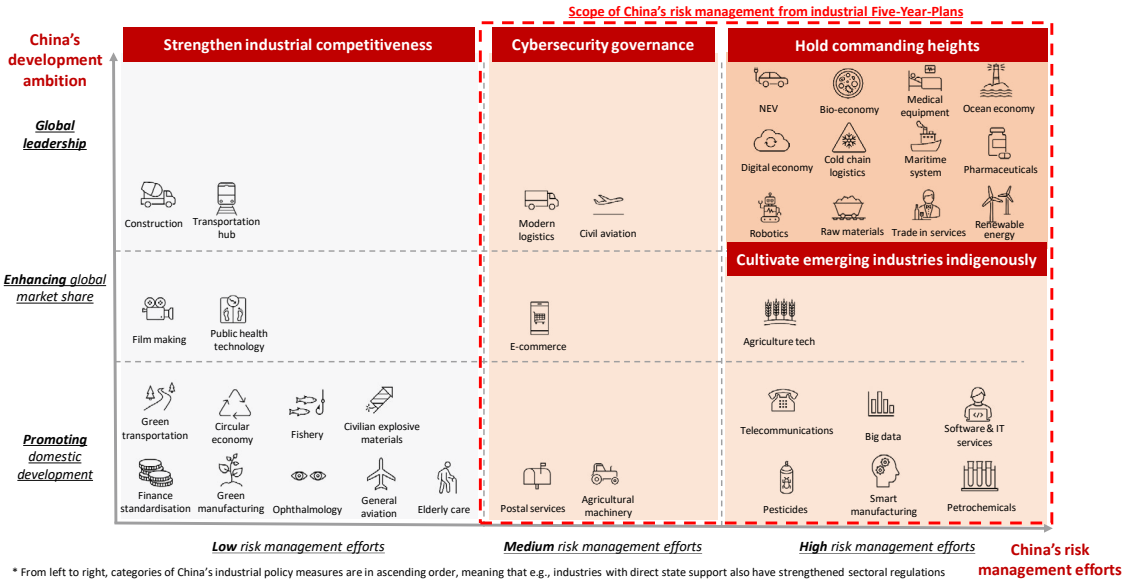
168 *Opinions of the State Council on Further Optimising the Foreign Investment Environment and Increasing Efforts to Attract Foreign Investment,* State Council, 13th August 2023, viewed 26th October 2023, <https://www.gov.cn/zhengce/content/202308/content_6898048.htm>

169 CMG conducted a textual analysis of sectoral FYPs issued by multiple ministries in China. The respective industrial development target in each FYP has been analysed; while the respective industrial policy instruments in the FYPs have been examined against the six risk management measures identified in this report, to understand how China has been doing risk management for each specific industry. It is important to note that only sectoral FYPs have been analysed, with no focus on other industrial regulations and policies. While also relevant in this context, especially with regard to shielding itself from external shocks and managing financial risks, the financial sector is not included in this sectoral view because, from the regulators' point of view, the financial sector is part of the political system and thus does not follow industrial development logic.

building ‘trump cards’ and tightening sectoral governance.

- **Hold commanding heights:** This cluster is of strategic importance to China since it strives to achieve global commercial leadership in these sectors. It is not surprising that China has emphasised economic security a lot for these industries and has adopted comprehensive risk management measures. Many of the six risk management measures have been identified in the industrial instruments of the respective sectoral FYPs, such as building ‘trump cards’, achieving technology breakthroughs and building self-reliance.

Figure 8: Analysis of security and development policy elements in China’s sectoral 14FYPs



Source: China’s Sectoral 14FYPs

Conclusion and outlook

China’s increased risk management efforts reflect the perception that threats facing the country’s development are multiplying and must be managed through policy action. There are similar threads that tie China’s approach to the EU’s, including a focus on securing supply chains for critical goods; strengthening domestic industrial capacity; mastering key technologies; and defending against cyberattacks that can threaten critical infrastructure. One key difference, however, is the degree to which China has pursued such initiatives, with the goals of achieving a high degree of ‘controllability’ of its industrial system, technological self-reliance and supply chain security having become of paramount importance.

As such, China has the most comprehensive approach to developing its toolkit compared to both the EU and the US, albeit one that is more targeted towards mitigating its own vulnerabilities rather than hindering geopolitical rivals, as has been argued to be the case for the US.

At the same time, China is increasingly bolstering its retaliatory capabilities. It now has the legal framework in place to ‘strike back’, particularly when it comes to imposing potential restrictions on critical raw earth metals and minerals. Whether it will look to implement more pre-emptive measures in the future, in a bid to enhance its own security or technological primacy, is yet to be seen.

A key question in this regard is how, or if, Chinese policymakers' definition of 'national security' will evolve, and whether any subsequent definition—and with it China's policy toolkit—will be narrow and precise, or will potentially be expanded. Past trends, and the more complex geopolitical environment Chinese policymakers see themselves operating in—including in relation to the deepening of coordination around global geoeconomic initiatives within the G7—suggests that the latter is more likely.

US 'DE-RISKING': FROM DECOUPLING TO STRATEGIC PRE-EMPTION

"[W]e are protecting our foundational technologies with a small yard and high fence. As I've argued before, our charge is to usher in a new wave of the digital revolution – one that ensures that next-generation technologies work for, not against, our democracies and our security. We've implemented carefully tailored restrictions on the most advanced semiconductor technology exports to China. Those restrictions are premised on straightforward national security concerns."

Jake Sullivan
US National Security Advisor
27th April 2023

"We cannot let China get these chips. Period. We're going to deny them our most cutting-edge technology."

Gina Raimondo
US Commerce Secretary
2nd December 2023

Introduction

Gone are the days when the US vowed to pursue a "positive, constructive, and comprehensive relationship with China".[170] In recent years, Washington has come to view the US-China economic relationship increasingly as asymmetric and beneficial to a Chinese regime intent on attaining technological leadership for geostrategic purposes, through industrial policy programmes such as the CM2025 initiative or the 'military-civil fusion' (MCF) strategy.[171&172] In response, the US began to alter the approach towards its bilateral relationship with China starting from the Obama administration, then intensifying under the Trump administration, which framed relations with Beijing as a "strategic competition".[173]

Unfulfilled hopes for China's economic and political liberalisation, after years of engagement and integrating the country into the global economy—as well as China becoming more assertive internationally—has paved the way for a more confrontational mind-set in the US. China is now seen by the US as a major threat to national security, economic prosperity and liberal democratic values.[174]

Since 2017, the US has ramped up measures to decouple from China to varying degrees, which can be divided into three general phases.

Phase 1: Broad decoupling, 2017–2021

US policymakers had already started to take measures to reduce the flow of technology products, services and inputs

170 *National Security Strategy,* The White House, May 2010, viewed 11th December 2023, <https://obamawhitehouse.archives.gov/sites/default/files/rss_viewer/national_security_strategy.pdf>

171 *Translation: Notice of the State Council on the Publication of the "Made in China 2025"*, Center for Security and Emerging Technology, 10th March 2022, viewed 15th December 2023, <https://cset.georgetown.edu/publication/notice-of-the-state-council-on-the-publication-of-made-in-china-2025/>

172 *Military-Civil Fusion and the People's Republic of China*, US Department of State, 20th January 2021, viewed 15th December 2023, <https://www.state.gov/wp-content/uploads/2020/05/What-is-MCF-One-Pager.pdf#:~:text=%E2%80%9CMilitary-Civil%20Fusion%2C%E2%80%9D%20or%20MCF%2C%20is%20an%20aggressive%2C%20national,the%20most%20technologically%20advanced%20military%20in%20the%20world.>

173 *National Security Strategy of the United States of America*, December 2017, viewed 11th December 2023, <https://trumpwhitehouse.archives.gov/wp-content/uploads/2017/12/NSS-Final-12-18-2017-0905.pdf>

174 Ibid.

to and from China under President Barack Obama but did so under a framework of economic engagement and the premise that China's economic growth would also benefit the US.[175]

However, with China increasingly attaining economic scale and the technological and military capacity to challenge the current international order, the US under President Donald Trump concluded that engagement had failed.[176] In response to rising national security concerns with regard to the "fusion of strategic state interests and private commercial motivations[…]as well as increasing asymmetries in market access and the terms of global competition,"[177] the US started ramping up measures to disentangle the US economy from China in areas seen as critical to US national security.

The decoupling measures in this first phase were often broad, such as the Section 301 trade war tariffs, the costs of which were largely borne by US businesses and consumers.[178]

Phase 2: Building internal capacity and selective decoupling, 2021–2022

Against the backdrop of a US-China relationship that further deteriorated in the aftermath of the COVID-19 pandemic, the Biden administration shifted focus towards domestic industrial revival. The strategy walked back the comparatively isolationist approach of the previous administration, with the aim of building "resilience and capacity at home and forg[ing] more effective partnerships abroad."[179]

The pandemic exposed structural vulnerabilities to economic and national security in the US, resulting from underinvestment in industries, which had created supply-chain bottlenecks across the economy.[180] The focus of economic security began to shift towards restricting China's access to predominantly top-level US innovation, refining the broad decoupling approach endorsed by the previous administration in favour of more targeted measures.

Recognising China's importance in the global economy, the US' approach centred more on engagement or, in the words of Secretary of State Antony Blinken, being "competitive when it should be, collaborative when it can be, and adversarial when it must be."[181]

Phase 3: Outcompeting and strategic pre-emption, 2022–

US national security policy took a significant turn on 7th October 2022, when the US Department of Commerce's Bureau of Industry and Security (BIS) issued landmark export controls on semiconductors and chip-making equipment. This move is aimed at preventing China from attaining leading-edge chip technology. It also blocks American AI chip designers from selling to China their high-end chips for AI and supercomputing, effectively kneecapping China's semiconductor production capability in key technology 'chokepoints'.[182]

In addition to unilateral export controls, Washington is also aiming to put more emphasis on collective action under its

175 *Degrees of Separation: A Targeted Approach to U.S.-China Decoupling – Final Report*, Center for Strategic and International Studies (CSIS), 21st October 2021, viewed 11th December 2023, <https://www.csis.org/analysis/degrees-separation-targeted-approach-us-china-decoupling-final-report>

176 *National Security Strategy of the United States of America,* The White House, December 2017, viewed 11th December 2023, <https://trumpwhitehouse.archives.gov/wp-content/uploads/2017/12/NSS-Final-12-18-2017-0905.pdf>

177 Rosen, Daniel H. & Gloudeman Lauren, *Understanding US-China Decoupling: Macro Trends and Industry Impacts*, Rhodium Group, 17th February 2021, viewed 11th December 2023, <https://www.uschamber.com/assets/archived/images/024001_us_china_decoupling_report_fin.pdf

178 Kerry, Cameron F; Lovely, Mary E; Singh, Pavneet; Tobin, Liza; Kim, Patricia M & Kimball, Emilie, *Is US security dependent on limiting China's economic growth?*, Brookings, 3rd October 2023, viewed 12th December 2023, <brookings.edu/articles/is-us-security-dependent-on-limiting-chinas-economic-growth/>

179 *Remarks on a Modern American Industrial Strategy by NEC Director Brian Deese*, The White House, 20th April 2022, viewed 12th December 2023, <https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/04/20/remarks-on-a-modern-american-industrial-strategy-by-nec-director-brian-deese/>

180 Ibid.

181 *A Foreign Policy for the American People*, US Department of State, 3rd March 2021, viewed 12th December 2023, <https://www.state.gov/a-foreign-policy-for-the-american-people/>

182 "The term technological chokepoints is often used in reference to critical technologies, components or resources that are essential to the functioning of key industries, economies or military capabilities. In this context, chokepoints can be used to limit a country's access to critical technologies or to gain leverage over other countries or companies.": Jie, Yu, *China's new scientists: The emerging leaders behind China's drive for technological self-reliance,* Chatham House, 24th July 2023, viewed 14th December 2023, <https://www.chathamhouse.org/2023/07/chinas-new-scientists/breaking-chinas-technological-chokepoints>

"invest, align, compete" framing: i.e., investing in domestic strength, building coalitions to shape the global strategic environment, and modernising military strength. In the 2022 National Security Strategy, the Biden administration outlined its goals to outcompete strategic competitors and shape the rules of the road for technology, cybersecurity, and trade and economics in partnership with allies.[183]

Key concerns and drivers of the US' approach to economic security and risk management

In a policy speech in April 2023, National Security Advisor Jake Sullivan signalled the US Government's move away from 'decoupling' rhetoric in favour of the 'de-risking' framing espoused by EU Commission President Ursula von der Leyen. Sullivan put forward the US' proposition, vowing to protect its foundational technologies with a "small yard and high fence."[184] Just a few days earlier, US Treasury Secretary Janet Yellen had rejected the idea of full decoupling from China on the grounds that it would be "disastrous for both countries[…]and destabilizing for the world."[185]

The US' approach to economic security and risk management reflects its overall perception that China is the "only competitor potentially capable of combining its economic, diplomatic, military and technological power to mount a sustained challenge to a stable and open international system."[186]

This position is borne out through policy stances from Washington that show a clear intent to not only address market access and trade asymmetries perceived as unfair, but also thwart Beijing's industrial and military development based on broadly defined national security concerns, including by taking strategic pre-emptive measures. For example, during a US defence forum in December 2023, Commerce Secretary Gina Raimondo noted that China does not have "the most high-end computer semiconductors" that America has. She further stated that, "If we can deny [China] the chips they can't run the models, then they can't use that to advance their military capability. We cannot let China get these chips. Period."[187] She went on to clarify in an interview that while the US does not think it can block China's development, it can try to slow it down, noting, "Ultimately, we just have to run faster. Do more, run faster, so we can always be ahead."[188]

The idea of "running faster" is one area where the US' and the EU's respective approaches to risk management share common roots. Many of Washington's policies aim to preserve and strengthen US industrial competitiveness and technological leadership. However, this too has a strong link back to overall military concerns. The erosion of US manufacturing capacity that has taken place over the last several decades poses a threat to the country's defence industrial base, whereby American manufacturers are increasingly seen as unable to "meet national security requirements".[189]

Another area of similarity with EU de-risking, is that the US' approach to risk management and efforts to bolster economic security has also been shaped by the need to secure supply chains for critical goods. The disruptions caused by the COVID-19 pandemic, and resulting protective measures by certain governments to restrict the export of products needed at home, laid bare the vulnerabilities in the US domestic supply chain, and, much like the EU, Washington is eager to close those gaps.

183 *National Security Strategy,* The White House, 12th October 2022, viewed 12th December 2023, <https://www.whitehouse.gov/wp-content/uploads/2022/11/8-November-Combined-PDF-for-Upload.pdf>

184 *Remarks by National Security Advisor Jake Sullivan on Renewing American Economic Leadership at the Brookings Institution,* The White House, 27th April 2023, viewed 12th December 2023, <https://www.whitehouse.gov/briefing-room/speeches-remarks/2023/04/27/remarks-by-national-security-advisor-jake-sullivan-on-renewing-american-economic-leadership-at-the-brookings-institution/>

185 Heng, Weili, *Yellen opposes China 'decoupling', China Daily*, 21st April 2023, viewed 12th December 2023, <https://www.chinadaily.com.cn/a/202304/21/WS6441f20aa310b6054faceefd.html>

186 *Interim National Security Strategic Guidance*, The White House, March 2021, viewed 12th December 2023, <https://www.whitehouse.gov/wp-content/uploads/2021/03/NSC-1v2.pdf>

187 *Remarks unbefitting of a commerce secretary: China Daily editorial, China Daily*, 4th December 2023, viewed 12th December 2023, <https://www.chinadaily.com.cn/a/202312/04/WS656dc0f8a31090682a5f15dd.html>

188 Cheng, Evelyn, *U.S. export controls need to 'change constantly' even if it's tough for businesses, Secretary Raimondo says, CNBC*, 5th December 2023, viewed 12th December 2023, <https://www.cnbc.com/2023/12/05/commerce-sec-raimondo-us-export-controls-need-to-change-constantly.html>

189 *National Security Strategy of the United States of America,* The White House, December 2017, viewed 11th December 2023, <https://trumpwhitehouse.archives.gov/wp-content/uploads/2017/12/NSS-Final-12-18-2017-0905.pdf>

A 2021 White House report, focusing on semiconductors, batteries, critical minerals and pharmaceuticals,[190] highlighted key supply chain vulnerabilities, and called for more diversification and a reduction of the risks of supply concentration. For instance, insufficient domestic manufacturing capacity, misaligned incentives and short-termism discouraging private investment, in addition to geographical concentration in global sourcing, resulted in the US' share of global semiconductor production dropping from 37 to 12 per cent between 1990 and 2021. The Biden administration argued that tools, including ally- and friend-shoring, and stockpiling, along with investments in sustainable domestic production and processing, will all be necessary to strengthen resilience in this area.

Under the "build back better" motto, the Biden administration laid out a new industrial strategy in 2021, with the stated goals being to "sustain and expand [US] economic and technological influence, make [the US'] economy and supply chains more resilient, [and] sharpen our competitive edge."[191] This announcement was followed by a flurry of sizeable investment packages, such as the Bipartisan Infrastructure Law (BIL),[192] the CHIPS and Science Act and the Inflation Reduction Act (IRA), to bolster the US' technology ecosystem.

A further parallel between the US' and the EU's approaches can be seen in the shared need to identify and eliminate cyber threats. According to findings from the 2018 Section 301 report, China conducts and supports "unauthorized cyber intrusions into US companies' networks to access sensitive information and trade secrets".[193] In response, the US ramped up its toolkit to prevent the theft of trade secrets, economic espionage and malign foreign investment, thus increasing protection for critical infrastructure. Since 2019, national security agencies have imposed new restrictions on access to US infrastructure and pushed the Federal Communications Commission (FCC) to impose harsher restrictions to invest in or acquire US firms on Chinese entities that are perceived as "vulnerable to exploitation, influence, and control by the Chinese government".[194]

There have also been calls for the US and its allies to maintain "their ability to exert leverage over China."[195] These include, for example, exploiting China's dependence on the US dollar (USD), and imports of US food, energy and technology, as well as the desire of Chinese elites to maintain access to US real estate, and its financial markets and education system, as a means to exert coercive force.

The direction and scope of the US' approach to economic security and risk management

An early manifestation of the US' strategy for managing perceived risks to its economic security was the 2018 United States Trade Representative's (USTR's) Section 301 investigation, which found that "China's acts, policies, and practices related to technology transfer, intellectual property (IP), and innovation were unreasonable or discriminatory and burdened or restricted U.S. commerce".[196] This led the Trump administration to impose wide-ranging tariffs of 10 to 25 per cent on a large proportion of Chinese imports to the US, with over 800 tariff lines in total. They resulted in a reduction in China's share of US imports from 21.6 per cent in 2018 to 17.1 per cent in 2022.[197] Despite persistent complaints from multinational companies, these tariffs remain in place.

To curb technology leakage, the US also broadened the jurisdiction of the Committee on Foreign Investment in the

190 *Building Resilient Supply Chains, Revitalizing American Manufacturing, and Fostering Broad-based Growth: 100-Day Reviews Under Executive Order 14017*, The White House, June 2021, viewed 12th December 2023, <https://www.whitehouse.gov/wp-content/uploads/2021/06/100-day-supply-chain-review-report.pdf>

191 *The Administration's Approach to the People's Republic of China*, US Department of State, 26th May 2022, viewed 12th December 2023, <https://hk.usconsulate.gov/n-2022052601/>

192 Also known as the Infrastructure Investment and Jobs Act.

193 *United States Strategic Approach to the People' Republic of China,* The White House, 26th May 2020, viewed 12th December 2023, <https://www.whitehouse.gov/wp-content/uploads/2020/05/U.S.-Strategic-Approach-to-The-Peoples-Republic-of-China-Report-5.24v1.pdf>

194 Chan, Adam, CFIUS, *Team Telecom and China*, Lawfare, 28th September 2021, viewed 12th December 2023, <https://www.lawfaremedia.org/article/cfius-team-telecom-and-china>

195 Boustany Jr., Charles W. & Friedberg, Aaron, L., *Answering China's Economic Challenge: Preserving Power, Enhancing Prosperity*, The National Bureau of Asian Research, February 2019, viewed 12th December 2023, <https://www.nbr.org/wp-content/uploads/pdfs/publications/special_report_76_answering_chinas_economic_challenge>

196 *Findings of the Investigation into China's Acts, Policies, and Practices related to Technology Transfer, Intellectual Property, and Innovation under Section 301 of the Trade Act of 1974,* Office of the United States Trade Representative, 22nd March 2018, viewed 10th January 2024, <https://ustr.gov/issue-areas/enforcement/section-301-investigations/section-301-china/investigation>

197 UN Comtrade Database, United Nations, <https://comtradeplus.un.org/>

United States (CFIUS) in 2018, over transactions involving "critical technology", "critical infrastructure" or "sensitive personal data". Following the introduction of this measure, China's FDI into the US dropped by 97 per cent between 2017 and 2022, shrinking in relative terms from 5.5 to 0.2 per cent.[198]

In the same year, the US Department of Justice launched the China Initiative – a campaign to investigate and prosecute the theft of trade secrets, espionage, foreign influence activities, supply chain subversion and other threats from China. Several Chinese and Chinese-surnamed researchers were charged, however many were subsequently acquitted.[199]

The US also ramped up export controls, arguing that national security "requires that the US maintain its leadership in the science, technology, engineering, and manufacturing sectors, including foundational technology that is essential to innovation."[200]

While under President Biden the US dropped certain measures, such as the China Initiative, it further refined its toolkit to "outcompete" rivals.[201] National Security Advisor Jake Sullivan made clear in a speech on 16th September 2022 that US leadership in computing-related technologies, bio-technologies and manufacturing, and clean energy technologies had become a national security imperative, with these areas now considered both foundational and 'force multipliers' throughout the US' technology ecosystem, including for military technology.[202]

To protect the country's technological advantages, and to prevent the theft of IP and the use of US technologies against the US or its people, Sullivan argued that the US would have to revisit its approach to export controls, modernise its investment screening systems and address outbound investments in sensitive technologies, to maintain "as large of a lead as possible".[203] He thereby rejected the previous "sliding scale" approach of maintaining a relative advantage over competitors in key technologies and staying only a few generations ahead.

On 7th October 2022, the BIS enacted export controls that could thwart China's ability to develop its own advanced chips past a certain technology threshold.[204] The controls restrict Chinese imports of advanced manufacturing equipment and bar US personnel from working in certain China-based facilities. The broad language of the new controls, coupled with the fact that advanced chip technology used for commercial purposes could theoretically have potential military applications, means many businesses that use advanced chips are at risk of being impacted by the development, something that is indicated by trade statistics. While US export controls only affect less than one per cent of bilateral trade, according to the US administration,[205] the new restrictions led to a 22.5 per cent drop in exports of chip-related products to China in 2022, with a further drop of 38.3 per cent in the first eight months of 2023.[206]

198 *Data on new foreign direct investment in the United States*, US Bureau of Economic Analysis, accessed 28th September 2023, <https://apps.bea.gov/iTable/?reqid=2&step=1&isuri=1#eyJhcHBpZCI6Miwic3RlcHMiOlsxLDIsMyw0LDUsNywxMCwxMF0sImRhdGEiOltbIlN0ZXAxUHJvbXB0MSIsIjIiXSxbIlN0ZXAxUHJvbXB0MiIsIjMiXSxbIlN0ZXAyUHJvbXB0MyIsIjEiXSxbIlN0ZXAzUHJvbXB0NCIsIjYyIl0sWyJTdGVwNFByb21wdDUiLCIyNSJdLFsiU3RlcDVQcm9tcHQ2IiwiMSJdLFsiU3RlcDdQcm9tcHQ4IixbIjY2IiwiNjUiLCI2MSIsIjYwIiwiNTgiLCI1NiJdXSxbIlN0ZXA4UHJvbXB0OUEiLFsiMSJdXSxbIlN0ZXA4UHJvbXB0MTBBIixbIjEiXV1dfQ==>

199 Kerry, Cameron F; Lovely, Mary E; Singh, Pavneet; Tobin, Liza; Kim, Patricia M & Kimball, Emilie, *Is US security dependent on limiting China's economic growth?*, Brookings, 3rd October 2023, viewed 12th December 2023, <brookings.edu/articles/is-us-security-dependent-on-limiting-chinas-economic-growth/>

200 *50 U.S. Code § 4811 – Statement of policy,* Legal Information Institute, August 2018, viewed 12th December 2023, <https://www.law.cornell.edu/uscode/text/50/4811>

201 *National Security Strategy*, The White House, October 2022, viewed 12th December 2023, <https://www.whitehouse.gov/wp-content/uploads/2022/11/8-November-Combined-PDF-for-Upload.pdf>

202 *Remarks by National Security Advisor Jake Sullivan at the Special Competitive Studies Project Global Emerging Technologies Summit,* The White House, 16th September 2022, viewed 12th December 2023, <https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/09/16/remarks-by-national-security-advisor-jake-sullivan-at-the-special-competitive-studies-project-global-emerging-technologies-summit/>

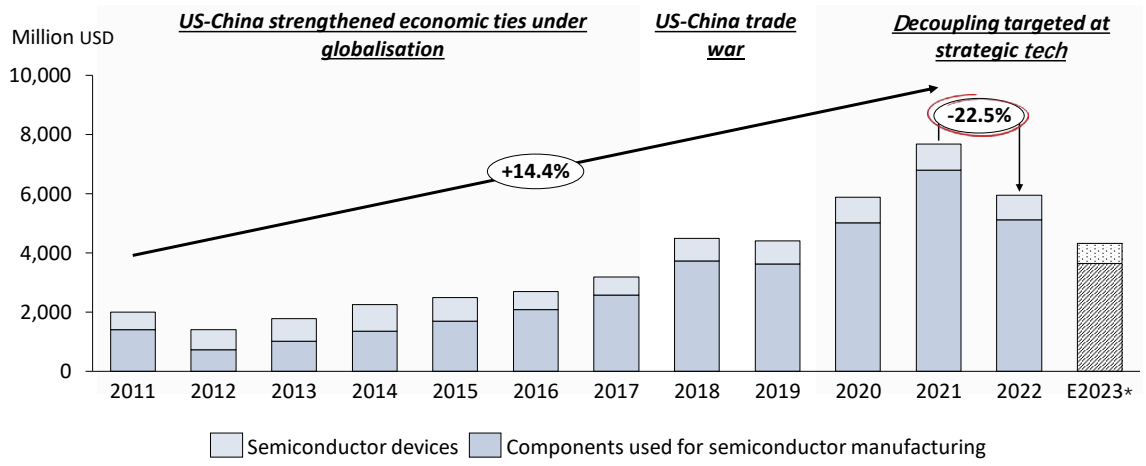
203 Weinstein, Emily, *The Role of Taiwan in the U.S. Semiconductor Supply Chain Strategy,* The National Bureau of Asian Research, 21st January 2023, viewed 12th December 2023, <https://www.nbr.org/publication/the-role-of-taiwan-in-the-u-s-semiconductor-supply-chain-strategy/#:~:text=As%20National%20Security%20Advisor%20Jake%20Sullivan%20declared%20in,lead%20as%20possible%20over%20competitors%20like%20the%20PRC.>

204 *Commerce Implements New Export Controls on Advanced Computing and Semiconductor Manufacturing Items to the People's Republic of China (PRC),* BIS, US Department of Commerce, 7th October 2022, viewed 15th December 2023, <https://www.bis.doc.gov/index.php/documents/about-bis/newsroom/press-releases/3158-2022-10-07-bis-press-release-advanced-computing-and-semiconductor-manufacturing-controls-final/file>

205 Swanson, Anna; Rappeport, Alan & Bradsher, Keith, *U.S. Commerce Secretary Faces a Wide Range of Issues in China, The New York Times*, 27th August 2023, viewed 14th December 2023, <https://www.nytimes.com/2023/08/27/business/gina-raimondo-china-agenda.html>

206 UN Comtrade Database, United Nations, <https://comtradeplus.un.org/>; data based on China Customs, HS Code 8486 and 8541.

Figure 9: US exports of semiconductor products to China[1)]



1) Semiconductor products sampled as HS8541 & HS8463

Source: UN Comtrade; estimates for 2023 based on extrapolation of real data from January to July 2023

In 2023, the Netherlands and Japan—which have companies that dominate two of the three semiconductor 'chokepoints'—adopted similar export controls, thus increasing the effectiveness of the US' measures.[207] On 17th October 2023, the BIS further tightened its grip with the release of updated export control rules in order to close loopholes that companies like Nvidia had used to circumvent the earlier measures, and to align with controls adopted by the Netherlands and Japan.

It was in the same vein that, in September 2022, President Biden expanded the technology sectors that CFIUS oversees beyond the defence industrial base.[208] And on 9th August 2023, the administration released an executive order (EO) to screen outbound investment in "sensitive technologies and products in the semiconductors and microelectronics, quantum information technologies, and AI sectors that are critical for the military, intelligence, surveillance, or cyber-enabled capabilities of a country of concern," signalling a further broadening of the US' toolbox.[209] The US Treasury Department will need to approve such investments, and is likely to set up a working group to implement the EO in 2024.

In addition to these measures, significant subsidy packages aimed at boosting economic development have been deployed. For example, the BIL is providing USD 1.2 trillion in public investment to bolster US infrastructure, laying the foundations for industrial renewal, more efficient supply chains, and more resilient and secure infrastructure. Building on the industrial strategy to revitalise domestic manufacturing in critical areas, President Biden signed into law the CHIPS and Science Act, which makes available nearly USD 53 billion of investment into semiconductor R&D

207 These chokepoints are semiconductor design, broadly controlled by the US; extreme ultraviolet (EUV) and deep ultraviolet (DUV) lithography technologies, dominated by Dutch companies; and downstream photonics, dominated by Japanese companies.

208 *Executive Order on Ensuring Robust Consideration of Evolving National Security Risks by the Committee on Foreign Investment in the United States*, The White House, 15th September 2022, viewed 12th December 2023, <https://www.whitehouse.gov/briefing-room/presidential-actions/2022/09/15/executive-order-on-ensuring-robust-consideration-of-evolving-national-security-risks-by-the-committee-on-foreign-investment-in-the-united-states/>

209 *Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern,* The White House, 9th August 2023, viewed 12th December 2023, <https://www.whitehouse.gov/briefing-room/presidential-actions/2023/08/09/executive-order-on-addressing-united-states-investments-in-certain-national-security-technologies-and-products-in-countries-of-concern/>

and manufacturing, and the general workforce.[210] The overarching goal is to "restore US leadership in semiconductor manufacturing and R&D and reduce [US] overreliance on foreign-produced chips."[211]

CHIPS and Science Act funding comes with significant guardrails, with conditions proposed in March 2023 that: "the Act includes certain limitations on funding recipients, such as prohibiting engagement in certain significant transactions involving the material expansion of semiconductor manufacturing capacity in foreign countries of concern and prohibiting certain joint research or technology licensing efforts with foreign entities of concern."[212]

The IRA is another key piece of legislation that is designed to reduce external risks and boost domestic manufacturing capacity. It earmarks around USD 370 billion in funding to "support new infrastructure investments in the areas of clean energy, transportation and the environment," with financial support often tied to local production or sourcing requirements.[213] It aims to "lower energy costs for families and small businesses, accelerate private investment in clean energy solutions in every sector of the economy and every corner of the country, strengthen supply chains for everything from critical minerals to efficient electric appliances, and create good-paying jobs and new economic opportunities for workers."[214] Given that the IRA is supposed to facilitate the overall green energy transition, it can be seen as an integral part of the US' overarching aim of ensuring the security of critical infrastructure.

It was also within the scope of securing critical infrastructure that several Chinese firms, including China Mobile, China Unicom and China Telecom, had their licences to operate in the US denied or revoked by the FCC.[215,216&217] In March 2021, the Secure and Trusted Communications Network Act established a list containing entities whose equipment is denied from being sold to the US. The list initially only contained five companies—Huawei, ZTE, Hytera, Hikvision and Dahua—but was further expanded in March 2022 to include Kaspersky Lab, China Mobile and China Telecom, and then again in September 2022 to include Pacific Networks and China Unicom.[218] Between 2018 and 2022, Chinese exports of telecommunications products to the US declined by three per cent, after having experienced an increase of 12.1 per cent from 2011 to 2017.[219]

210 *Fact Sheet: CHIPS and Science Act Will Lower Costs, Create Jobs, Strengthen Supply Chains, and Counter China,* The White House, 9th August 2022, viewed 30th December 2023, <https://www.whitehouse.gov/briefing-room/statements-releases/2022/08/09/fact-sheet-chips-and-science-act-will-lower-costs-create-jobs-strengthen-supply-chains-and-counter-china/>

211 *Remarks by National Security Advisor Jake Sullivan at the Special Competitive Studies Project Global Emerging Technologies Summit,* The White House, 16th September 2022, viewed 12th December 2023, <https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/09/16/remarks-by-national-security-advisor-jake-sullivan-at-the-special-competitive-studies-project-global-emerging-technologies-summit/>

212 *Preventing the Improper Use of CHIPS Act Funding,* Federal Register, The Daily Journal of the United States Government, 3rd March 2023, viewed 13th December 2023, <https://www.federalregister.gov/documents/2023/03/23/2023-05869/preventing-the-improper-use-of-chips-act-funding>

213 *Inflation Reduction Act: Infrastructure Implementation Resources,* National Governors Association, last updated 11th December 2023, viewed 13th December 2023, <https://www.nga.org/ira-resources/#:~:text=The%20Inflation%20Reduction%20Act%20%28IRA%29%20was%20signed%20into,areas%20of%20clean%20energy%2C%20transportation%20and%20the%20environment.>

214 *Building a Clean Energy Economy: A Guidebook to the Inflation Reduction Act's Investments in Clean Energy and Climate Action,* The White House, January 2023, viewed 13th December 2023, <https://www.whitehouse.gov/wp-content/uploads/2022/12/Inflation-Reduction-Act-Guidebook.pdf>

215 *FCC Denies China Mobile USA Application to Provide Telecommunications Services*, FCC, 9th May 2019, viewed 13th December 2023, <https://docs.fcc.gov/public/attachments/DOC-357372A1.pdf#:~:text=In%20the%20Memorandum%20Opinion%20and%20Order%20adopted%20by,international%20telecommunications%20services%20is%20in%20the%20public%20interest.>

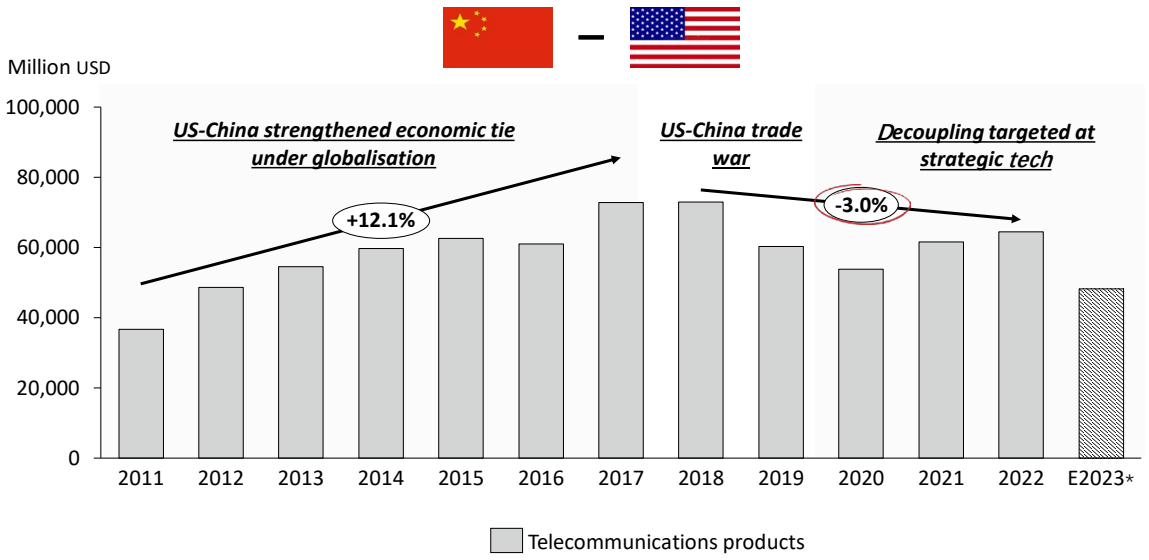
216 *FCC Revokes China Unicom America's Authority to Provide Telecom Services in America,* FCC, 27th January 2022, viewed 13th December 2023, <https://docs.fcc.gov/public/attachments/DOC-379680A1.pdf#:~:text=WASHINGTON%2C%20January%2027%2C%202022%E2%80%94The%20Federal%20Communications%20Commission%20adopted,and%20international%20telecommunications%20services%20within%20the%20United%20States.>

217 *FCC Revokes and Terminates China Telecom America's Authority to Provide Telecom Services in America*, FCC, 26th October 2021, viewed 13th December 2023, <https://docs.fcc.gov/public/attachments/DOC-376902A1.pdf>

218 *Public Safety and Homeland Security Bureau Announces Additions to the List of Equipment and Services Covered by Section 2 of the Secure Networks Act,* FCC, 20th September 2022, viewed 13th December 2023, <https://docs.fcc.gov/public/attachments/DA-22-979A1.pdf>

219 UN Comtrade Database, United Nations, <https://comtradeplus.un.org/>

Figure 10: Chinese exports of telecommunications products to the US [1)]



1) Telecommunications products sampled as HS8517

Source: UN Comtrade; estimates for 2023 based on extrapolation of real data from January to May 2023

Beyond unilateral measures, and as part of the US' new strategic approach to the PRC under the label of "invest, align, compete", the Biden administration has also vowed to better align policies with allies and partners. The aim is to "establish fair rules while also sustaining [the US'] economic and technological edge and shape a future defined by fair competition".[220]

This includes moves to cooperate and coordinate with like-minded partners more strongly on economic and trade policies, outside of traditional free trade agreements, as part of an "allied techno-industrial base".[221] One example is the US-EU Trade and Technology Council (TTC), which is a forum to coordinate policies that are "based on shared democratic values" on emerging technology standards, critical supply chain resilience and research collaboration. Another is the Indo-Pacific Economic Framework (IPEF), which includes 14 partners in the region, and seeks to coordinate policies on trade, supply chains, clean technology, infrastructure and taxation. The Joint Statement on Cooperation on Global Supply Chains, as well as the Minerals Security Partnership, also convene numerous partners to collaborate on enhancing supply chain resilience in key industries.

Conclusion and outlook

Despite attempts by the Biden administration to place the US' approach to risk management and strengthening economic security in the same context as EU de-risking, the different actions taken so far, and the overall aims, do not seem to substantiate such a comparison. There are similar threads that tie both approaches together, including the focus on securing supply chains for critical goods; renewing domestic industrial capacity; maintaining their relative advantages in certain key technologies; and defending against cyber-attacks that can threaten critical infrastructure and compromise their democratic systems through coordinated disinformation campaigns. Where they differ significantly is: 1) the scale of subsidies that the US is willing to invest (e.g., USD 58 billion under the US CHIPS and Science Act,

220 *National Security Strategy,* The White House, October 2022, viewed 12th December 2023, <https://www.whitehouse.gov/wp-content/uploads/2022/11/8-November-Combined-PDF-for-Upload.pdf>

221 Ibid.

compared to a total expected budget of (EUR) 15.8 billion for the European Chips Act);[222] and 2) that a part of the US' approach is targeted specifically against China, with pre-emptive measures being taken in an attempt to prevent the country from accessing high-end technologies that it could use to enhance its military capabilities.

One key reason for this second difference is that the strong military component that informs US' policy thinking, is not factored into EU de-risking given that the bloc has no military considerations under its direct purview. The US military currently assists in maintaining global security—including helping to provide stability along key shipping routes—in addition to the role it plays in supporting and defending the US Constitution and, by extension, free and democratic values more broadly. A China that could present a military challenge to the US is therefore perceived as a threat to these values globally, with the Biden administration believing that China: "harbors the intention and, increasingly, the capacity to reshape the international order in favor of one that tilts the global playing field to its benefit"; and that it, and others, "are working overtime to undermine democracy and export a model of governance marked by repression at home and coercion abroad."[223]

Nevertheless, while it may be clear that a period of unrestricted US-China engagement is over, policy debate over the exact type of relationship the US should have with China is still taking place.[224] A key question going forward will be how US policymakers define 'national security'. Contrary to the government's claims, the two latest measures on export controls and outbound investment suggest that the current administration is, at least to some extent, intent on blunting China's overall technological progress. At the same time, the administration has not yet presented any evidence that the semiconductor export controls it has imposed can effectively hamper Chinese military expansion.

What the controls have so far resulted in is notable revenue losses for US semiconductor companies such as Nvidia, Micron, Qualcomm and Intel. These firms' sales stand to shrink by around one third,[225] and it has been estimated that they "would lose 18% of the global market share and 37% of revenues if they could not do business in China."[226] The export controls could also potentially harm the US' and its allies' overall semiconductor competitiveness and their capacity to innovate, especially given that not only is China's pursuit of semiconductor self-reliance only likely to accelerate, but also because, "[e]very dollar of sales made in China is a dollar less the Chinese get and a dollar more U.S. firms get that they can use for innovation."[227]

For some multinational companies, the recent US measures that have been introduced have brought a great deal of uncertainty, for example, those with China operations that need stable access to semiconductors. In the European Chamber's *Business Confidence Survey 2023*, of the companies that had reviewed their supply chains, 12 per cent had done so in response to third-country legislation, including US export controls, among others. Just over a fifth of survey respondents said that their operations had either already been impacted, or that they expected them to be impacted, by US export control policies.[228]

There is also a perceived risk of a further deterioration of the downward tit-for-tat spiral with Beijing, as highlighted by the partial sales ban on the largest US memory chip manufacturer Micron, as well as the recent new export licensing requirements for gallium and germanium issued by China on 3rd July 2023. Such actions are seen as retaliatory

222 The European Chips Act, viewed 30th December 2023, <https://www.european-chips-act.com/>

223 *National Security Strategy,* The White House, 12th October 2022, viewed 12th December 2023, <https://www.whitehouse.gov/wp-content/uploads/2022/11/8-November-Combined-PDF-for-Upload.pdf>

224 Kerry, Cameron F; Lovely, Mary E; Singh, Pavneet; Tobin, Liza; Kim, Patricia M & Kimball, Emilie, *Is US security dependent on limiting China's economic growth?*, Brookings, 3rd October 2023, viewed 12th December 2023, <brookings.edu/articles/is-us-security-dependent-on-limiting-chinas-economic-growth/>

225 Atkinson, Robert, D., *Stronger Semiconductor Controls on China Will Likely Harm Allied Semiconductor Competitiveness*, Information Technology and Innovation Foundation, 12th October 2023, viewed 14th December 2023, <https://itif.org/publications/2023/10/12/stronger-semiconductor-export-controls-on-china-will-likely-harm-allied-semiconductor-competitiveness/>

226 Olson, Stephen, *Will US semiconductor restrictions on China backfire?*, Hinrich Foundation, 13th June 2023, viewed 14th December 2023, <https://www.hinrichfoundation.com/research/article/tech/will-us-semiconductor-restrictions-on-china-backfire/>

227 Atkinson, Robert, D., *Stronger Semiconductor Controls on China Will Likely Harm Allied Semiconductor Competitiveness*, Information Technology and Innovation Foundation, 12th October 2023, viewed 14th December 2023, <https://itif.org/publications/2023/10/12/stronger-semiconductor-export-controls-on-china-will-likely-harm-allied-semiconductor-competitiveness/>

228 *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, 21st June 2023, viewed 14th December 2023, <https://europeanchamber.oss-cn-beijing.aliyuncs.com/upload/documents/documents/European_Business_in_China_Business_Confidence_Survey_2023[1124].pdf>

against US export controls and other similar measures,[229] adding further fuel to the debate on how critical supply chains could be diversified away from China, regardless of how difficult, costly and slow it may be.

In terms of what the future may hold, new measures are being put forward that could further alter the US-China relationship, regardless of the administration. A recent report by the bipartisan United States House Select Committee on Strategic Competition between the United States and the Chinese Community Party proposes almost 150 recommendations to: 1) reset economic relations with China; 2) further curb technology leakage; and 3) strengthen investment in US leadership.[230]

229 Holderness, Alexander; Velazquez, Nicholas; Carroll, Henry, H., & Cook, Cynthia, *Understanding China's Gallium Sanctions*, Center for Strategic and International Studies, 7th July 2023, viewed 14th December 2023, <https://www.csis.org/analysis/understanding-chinas-gallium-sanctions>

230 *Reset, Prevent, Build: A Strategy to Win America's Economic Competition with the Chinese Communist Party,* The Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party, 12th December 2023, viewed 8th February 2024, <https://selectcommitteeontheccp.house.gov/sites/evo-subsites/selectcommitteeontheccp.house.gov/files/evo-media-document/reset-prevent-build-scc-report.pdf>

HOW EUROPEAN BUSINESS IN CHINA IS RESPONDING TO RISK AND EVOLVING SECURITY CONCERNS

The practice of assessing and mitigating risks in the business world is nothing new. It is something companies have always done when making investment and operational decisions. However, the challenges now being faced by many European firms in China, much of them resulting from the hyper concentration of supply chains in the country, suggests that competitive dynamics drove many to deprioritise resilience over the past decade or so. With the complexity and severity of the risks that businesses face having grown exponentially in recent years, companies are now having to allocate more resources to risk management and compliance activities than ever before.

This is very much the case for European firms in China, many of whom report that doing business in the country has become increasingly difficult.[231] Much of this can be attributed to China's market having become less predictable, reliable and efficient. The overall business environment has become more politicised, and companies are struggling to interpret rules and regulations—including those related to national security—that are often broadly defined and ambiguous.[232]

Many businesses also lack a clear line of sight as to what the future of doing business in China will look like for their sector in light of China's ambition to strengthen technological self-reliance, new regulatory dilemmas caused by geopolitical and geoeconomic tensions—especially between China and the US—and discriminatory risk management policies that favour domestic players. This, coupled with the fact that certain key data in China are now being subject to greater control,[233] means that foreign-invested enterprises are having to conduct risk assessments, due diligence and scenario planning on the basis of imperfect, or sometimes no, information. The result is that many are shifting from focusing predominantly on efficiency and cost considerations to building resilience, and has even left some questioning whether there is a future for them in the Chinese market.[234]

After reviewing their China operations and investment strategies, a significant number of European Chamber members have begun shifting investments and/or parts of their supply chains both into and out of China, depending on how they perceive both the risks they are facing and whether they believe their industry is 'welcomed'. The European Chamber's *Business Confidence Survey* (BCS) *2023* found the following:[235]

- **China's attractiveness as an investment destination has deteriorated:** The proportion of members that consider China a top-three investment destination dropped to the lowest levels on record,[236] and 11 per cent of respondents reported they had shifted investments out of China in 2022.[237]

231 In the European Chamber's *Business Confidence Survey 2023*, a record 64 per cent of respondents reported that doing business in China became more difficult in 2022. This was reported across the board, with a majority of respondents in all 17 sectors assessed reporting this to be the case. *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, 21st June 2023, viewed 23rd November 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124>

232 Wu, Wendy & Lo, Kinling, *China's data regulations need more 'clarity', EU companies say in survey, South China Morning Post*, 15th November 2023, viewed 24th November 2023, <https://www.scmp.com/economy/china-economy/article/3241529/chinas-data-regulations-need-more-clarity-eu-companies-say-survey> and *Fears for people and firms as China's new anti-espionage law comes in to effect, The Guardian*, 30th June 2023, viewed 24th November 2023, <https://www.theguardian.com/world/2023/jun/30/fears-for-people-and-firms-as-chinas-new-anti-espionage-law-comes-into-effect>

233 Access to important information related to the economy and regulations has already been significantly curtailed for foreign entities in recent years. For instance, in late 2022, Wind Information—China's largest financial data provider—restricted offshore users' access to business and economic data. Similarly, in March 2022, the National Bureau of Statistics discontinued the public release of its consumer confidence data, a series that it issued every month for over three decades, and in August 2023, the publication of urban unemployment data, broken down into age groups, was discontinued. For a summary of such developments and their impact on business, see: *European Business in China Position Paper 2023/2024*, European Union Chamber of Commerce in China, 20th September 2023, viewed 24th November 2023, <https://www.europeanchamber.com.cn/en/publications-position-paper>

234 *European Business in China Position Paper 2023/2024*, European Union Chamber of Commerce in China, 20th September 2023, viewed 24th November 2023, <https://www.europeanchamber.com.cn/en/publications-position-paper>

235 *European Business in China Business Confidence Survey 2023,* European Union Chamber of Commerce in China, 21st June 2023, viewed 10th October 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

236 55 per cent of respondents reported this to be the case, down 13 percentage points year-on-year, and down 21 percentage points compared to 2012's survey.

237 Notably, the same percentage of members reported in the Chamber's *Business Confidence Survey 2022* that they were considering shifting existing investments from China a year earlier. See: *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20th June 2022, viewed 10th October 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1020/Business_Confidence_Survey_2022>

- **Key business operations are being moved, both in and out of China:** 10 per cent of respondents reported they had shifted, or were in the process of shifting, their Asia HQ / business unit HQ out of China. A majority also reported having "significantly" or "moderately" localised their staffing,[238] data storage and IT infrastructure into China.

- **Companies have begun to silo their China supply chains, through both onshoring and offshoring:** Three quarters of respondents reported having re-evaluated their China supply chains over the past two years (2021–2023); 12 per cent said they were shifting parts of them away from China, and 24 per cent reported plans to further onshore parts of them into China.

Key risks faced by European businesses operating in China

Interviews conducted with European Chamber members found that there is no 'one size fits all' approach to risk management in China. Decisions are influenced by several factors, including company size, industry and operational structure. Even within single industries and among companies of a similar size/structure there can be vastly different strategies employed, as well as differing views on what the key risks of doing/not doing business in China are. Strategies are also often based on how key decision makers perceive China, the assumptions they have made on the future trajectory of its economy, and how they perceive China's relationships with key partners to develop, as well as their past successes and the current size of their footprint in the country.

The summary of key risks faced by Chamber members provided here is by no means exhaustive, but rather indicate some of the high-level challenges faced by a range of different businesses of different size and industry-focus. It is notable that some risks have a pull effect, in that to mitigate them companies opt to increase localisation and/or investment; other risks have a push effect, in that they compel companies to shift investments or parts of their operations away from the country.

Risk 1: Detaching from the China market

For a sizeable chunk of Chamber members, China constitutes an important part of their company's global revenues and/or represents the largest individual market globally for their industry.[239&240] The dynamism of the China market has also long been seen by many European businesses as an important contributor to their global competitiveness – this group of companies benefit from exposure to China's innovation ecosystem, as well as fierce competitors.[241] As such, many members view detaching from the Chinese market as being the main risk to their global operations. A CEO of a major energy company summarised this approach during a recent Chamber meeting, saying, "The energy industry has long viewed China as a 'fitness club' and a major growth market. Members in this industry have traditionally been some of the biggest investors in China and will likely continue to invest, despite business becoming more uncertain, given that China accounts for a substantive proportion of their global business. For such companies, this is a form of risk management."

238 The BCS 2023 found that 63 per cent of respondents had "moderately" or "significantly" localised their junior staff, 67 per cent their mid-level staff, 63 per cent their senior management, and 41 per cent their company board positions.

239 For instance, China accounted for 43 per cent of global chemicals sales in 2021 and for 41 per cent of global automotive sales in 2022. *Europe is the Second Largest Chemicals Producer in the World*, The European Chemicals Industry Council, 27th June 2023, viewed 25th November 2023, <https://cefic.org/a-pillar-of-the-european-economy/facts-and-figures-of-the-european-chemical-industry/profile/#h-china-dominates-chemical-sales-world-ranking>; *Passenger Car Sales (Units),* Knoema, viewed 25th November 2023, <https://knoema.com/atlas/topics/Transportation/Motor-Vehicle-Sales/Car-sales>

240 31 per cent of respondents to the European Chamber's *Business Confidence Survey 2023* reported that their EBIT margin for their China operations was higher than the EBIT margin for their global operations. *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 7, 21st June 2023, viewed 23rd November 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124>

241 For more on the differing views on the risks and rewards of the China market when it comes to innovation and companies' R&D activities, see: *China's Innovation Ecosystem: The Localisation Dilemma,* European Union Chamber of Commerce in China and the Mercator Institute for Chinese Studies (MERICS), 21st April 2023, viewed 25th November 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1077/China_s_Innovation_Ecosystem_the_localisation_dilemma>

Risk 2: Overexposure to the China market

Concerns that have emerged in recent years about being overexposed to the China market were amplified following Russia's invasion of Ukraine and the subsequent issuing of sanctions on Russia. Businesses have been forced to consider what the impact of a potential escalation of tensions in the Taiwan Strait would have on their operations, with some undertaking scenario planning and other actions. For example, one member in the IT and telecommunications sector noted that the company—which had the funds of its two Russian subsidies frozen following the country being sanctioned—now regularly repatriates its China profits, and is also taking steps to shift parts of its China operations geared towards serving global markets out of the country as a result.

Risk 3: Geopolitics

Many Chamber members fear they could be at risk of becoming collateral damage because of escalating geopolitical tensions. This is most prevalent in relation to the US-China strategic competition – especially when it comes to advanced technology and sanctions, or the threat of sanctions, imposed as part of the ongoing US-China trade war.[242] This kind of risk was also writ large after a representative office was opened in the Lithuanian capital of Vilnius in November 2021, under the name 'Taiwan' instead of 'Taipei', which is the name used in 20 EU Member States.[243] Viewing this as a challenge to the 'one China' policy, in December 2021 Beijing began blocking imports of Lithuanian products as well as European goods that contained Lithuanian components. This led to the EU taking China to the WTO over economic coercion against Lithuania and other EU Member States.[244]

Risk 4: Supply chain disruptions

The COVID-19 pandemic and Russia's invasion of Ukraine have highlighted the fragility of global supply chains. Following these events, European Chamber members began adopting a range of measures to mitigate related risks, including through increased stockpiling, diversification of suppliers and shifting investments either into or out of China.

In many cases, however, companies are unable to fully mitigate the risks they face through supply chain diversification, in part due to a lack of viable options/alternatives being available. The Chamber's BCS 2023 found that three quarters of Chamber members import critical components into China for which they cannot readily source alternatives. For some, this is due to fact that no substitute(s) exists, or that the substitute(s) they have identified are too expensive and/or pose compatibility and performance issues.[245] This is particularly the case when it comes to the advanced technology or manufacturing equipment that is needed for running factory operations, which members often import from their home-markets.

Members also face challenges when it comes to shifting their sourcing and production away from China, often due to a lack of production capacity and related infrastructure in other markets. One example of this is in the textile industry in which—despite there having been a reorientation of FDI away from China to other countries in Asia—businesses continue to be dependent on intermediate goods coming from China. In 2021, the Chinese market accounted for 32 per cent of global textile exports, while the second largest market, Bangladesh, accounted for just five per cent

242 This is most clearly seen in relation to the imposition of US-led export controls on advanced semiconductor technology—a development which 21 per cent of respondents to the BCS 2023 reported directly impacted or is expected to directly impact their China operations—as well as the imposition of +25 per cent tariffs on select imports from China destined for the US. For an overview of US semiconductor controls, see: Goujon, Reva; Dudley, Lauren; Kleinhans, Jan-Peter & Kratz, Agatha, *Freeze-in-Place: The Impact of US Tech Controls on China,* Rhodium Group, 21st October 2022, viewed 25th November 2023, <https://rhg.com/research/freeze-in-place/>; for a summary of the tariffs and their macro-level impact, see: Brown, Chad, *Four years into the trade war, are the US and China decoupling?,* Peterson Institute for International Economy, 20th October 2022, viewed 25th November 2023, <https://www.piie.com/blogs/realtime-economics/four-years-trade-war-are-us-and-china-decoupling>

243 Bermingham, Finbarr, *Slovenia tries to head off row with Beijing over Taiwan office, SCMP*, 31st January 2022, viewed 8th August 2022, <https://www.scmp.com/news/china/diplomacy/article/3165441/slovenia-tries-head-row-beijing-over-taiwan-office-saying-it>

244 Valero, Jorge & Whitelaw, Kevin, *EU Launches WTO Case Against China Over Lithuania Blockade, Bloomberg,* 27th January 2022, viewed 3rd August 2022, <https://www.bloomberg.com/news/articles/2022-01-27/eu-set-to-launch-wto-case-against-china-over-lithuania-blockade>

245 *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 19, 21st June 2023, viewed 23rd November 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124>

of global exports. Given this disparity, members in this industry report that it is not practical for them to fully offshore parts of their China operations to other markets.[246]

Risk 5: Conflicting legal regimes

Companies are at risk of being caught between conflicting legal regimes, due to recently adopted EU and Chinese legislation.

Geopolitical developments have prompted China to expand its toolkit aimed at protecting its national security and development interests, which has resulted in a more politicised business environment.[247] This is being exacerbated by the prevalence of ambiguity in new or updated laws and regulations, with European companies struggling to understand their compliance obligations, a factor that significantly decreases business confidence.[248]

The most recent examples of such ambiguity can be found in China's updated Anti-espionage Law and the new Foreign Relations Law.[249&250] While both laws contain references to the broader concept of 'national security', neither provide guidelines on what constitutes a national secret, raising the potential for both inconsistent implementation and compliance issues for businesses.

While the purpose of any law is to specify what is allowed and what is not, businesses tend to err on the side of caution in the absence of clear language and well-defined boundaries. This can deter new investments, the planning of which requires a thorough assessment of the destination business environment—including related risks—by carrying out rigorous due diligence. With no clear understanding of what kind of information can and cannot be obtained, what is required to fulfil compliance requirements and what could constitute an act that is "detrimental to China's national interests", conducting business intelligence operations becomes a high-risk activity.

It was on these grounds that reports in the first half of 2023 about raids by Chinese authorities on several US-invested consultancies raised concerns among businesses operating in China. The full details of these high-profile crackdowns have not been made public, but as the allegations against the companies in question alluded to the obtaining of 'sensitive information', without providing a clear definition of the term, companies were left wondering if they may face a similar outcome if they conduct due diligence.[251]

With the EU's Corporate Social Responsibility Directive (CSRD) having entered into force on 5th January 2023, European companies operating in China—particularly those in 'sensitive' regions—will increasingly find themselves torn between two legal regimes. The CSRD obliges all large and all listed companies operating in the EU to "disclose information on what they see as the risks and opportunities arising from social and environmental issues, and on the impact of their activities on people and the environment."

Such companies will need to prepare sustainability reports—including information on their sustainability policies,

246 *Textiles: XI (Harmonized System 1992 for Section),* The Observatory of Economic Complexity, viewed 25th November 2023, <https://oec.world/en/profile/hs/textiles>

247 In the BCS 2023, 59 per cent of respondents reported that China's business environment became more politicised in 2022, a nine per cent increase year-on-year. The Chinese Government is perceived as the main source of increased political pressure. A large percentage of respondents foresee the situation getting worse before it gets better. European *Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, pp. 37–38, 21st June 2023, viewed 2nd July 2023, <https://www.europeanchamber.com.cn/en/press-releases/3529>

248 According to the BCS 2023, ambiguous rules and regulations ranked as the top regulatory obstacle members face for the seventh year running. Ibid, pp. 27–28.

249 An updated version of the Anti-espionage Law was approved by China's legislature on 26th April 2023 and came into effect on 1st July 2023, expanding the scope of activities that could be categorised as espionage. While the old version of the law, first adopted in 2014, specifically applied to obtaining or sharing state secrets or intelligence, the new version also adds to this list "other documents, data, materials or items related to national security or interests". *A battle against spies in China is spooking locals and foreigners, The Economist*, 4th May 2023, viewed 2nd July 2023, <https://www.economist.com/china/2023/05/04/a-battle-against-spies-in-china-is-spooking-locals-and-foreigners?gclid=EAIaIQobChMIg9LTqMTv_wIV9MZMAh30ewJbEAMYASAAEgLQBfD_BwE&gclsrc=aw.ds>

250 The Foreign Relations Law, adopted by the Standing Committee of the 14th National People's Congress on 28th June 2023, puts an obligation on enterprises and citizens, among others, "to safeguard China's sovereignty, national security, dignity, honor and interests in the course of international exchanges and cooperation". Article 8 of the law also stipulates that "any organization or individual who commits acts that are detrimental to China's national interests in violation of this Law and other applicable laws in the course of engaging in international exchanges shall be held accountable by law". *The Law on Foreign Relations of the People's Republic of China, Xinhua*, 28th June 2023, viewed 2nd July 2023, <https://english.news.cn/20230628/28c7aedd386440ba9c370eb22476d430/c.html>

251 *China's raids on foreign firms hurt its own interests, Financial Times,* 10th May 2023, viewed 3rd July 2023 <https://www.ft.com/content/f956ab7c-7980-44e4-b2b4-5f101398e2b3>

environmental protection policies and actions, social responsibility and treatment of employees, and respect for human rights—for submission and publication.[252] Although, at the time of writing, the European Commission has put forward a proposal to postpone the deadline for the adoption of sector-specific standards under the CSRD from 30th June 2024 until 30th June 2026, companies will still have to find a way to meet the reporting requirements. This was raised as a serious concern by several European companies during interviews for this report.

The Corporate Sustainability Due Diligence Directive (CSDDD) was approved by the European Parliament on 1st June 2023. It will require EU-based companies to establish due diligence processes to ensure their entire operations—including subsidiaries, and up- and downstream suppliers—are in line with EU human rights and environmental standards.[253] As the date for reporting obligations under the new EU legislation draws closer, affected companies may be increasingly compelled to move out of 'sensitive' regions in China, while being pulled in the opposite direction by both Chinese authorities and customers applying pressure for them to maintain these operations.[254]

Risk 6: Non-compliance with China's cybersecurity legislation

Although China's regulatory authorities and standard-setting bodies have long been in the process of issuing legislation and standards on the protection of personal information and important data, many of the laws, guidelines and measures lack specificity, which poses serious operational and compliance challenges to European companies operating in China.

As outlined in the European Chamber's *Cybersecurity Sub-working Group Position Paper* and several other sectoral position papers in recent years, despite key regulations—including the Cybersecurity Law (CSL), the Data Security Law (DSL) and the Personal Information Protection Law (PIPL)—having been in force for many years,[255] certain key elements that are necessary for their roll-out still need to be clarified by lower-level rules and/or sectoral rules. For example, the DSL prescribed the publication of a catalogue of 'important data'; however, at the time of writing, no such catalogue has been released by the relevant authorities.

In addition, some requirements are overly stringent, causing operational burdens for businesses. These include regulatory security assessment thresholds that are relatively low, especially for larger MNCs that handle large volumes of customer or employee data; and the fact that data handlers may be unable to sign standard contracts or be certified for the cross-border handling of personal information once a regulatory security assessment has been triggered.

That being said, the Chinese authorities have sought to improve data governance regulations. For example, in August 2023, the State Council issued its *Opinions of the State Council on Further Optimising the Foreign Investment Environment and Increasing Efforts to Attract Foreign Investment* (*Opinions*). The *Opinions* includes a point on promoting convenient security management mechanisms for cross-border data flows. It also calls for certain cities and regions of China—including Beijing, Shanghai and the Greater Bay Area—to pilot the creation of a list of general data that is allowed to flow freely.[256]

Following the release of the *Opinions*, on 28th September 2023, the Cyberspace Administration of China (CAC) issued its draft *Provisions on Regulating and Promoting Cross-border Data Flow* (*Draft Provisions*). The *Draft Provisions* relieve companies of some of the major difficulties with cross-border data transfer, partly by specifying a

252 *Corporate sustainability reporting,* European Commission, viewed 10th July 2023, <https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en>

253 *MEPs push companies to mitigate their negative social and environmental impact,* European Parliament, 1st June 2023, viewed 10th July 2023, <https://www.europarl.europa.eu/news/en/press-room/20230524IPR91907/meps-push-companies-to-mitigate-their-negative-social-and-environmental-impact>

254 *European Business in China Business Confidence Survey 2023,* European Union Chamber of Commerce in China, p.39, 21st June 2023, viewed 10th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124>

255 The CSL came into effect on 1st June 2017, the DSL became effective on 1st September 2021 and the PIPL on 1st November 2021.

256 *Opinions of the State Council on Further Optimising the Foreign Investment Environment and Increasing Efforts to Attract Foreign Investment,* State Council, 13th August 2023, viewed 26th October 2023, <https://www.gov.cn/zhengce/content/202308/content_6898048.htm>

list of exemptions to relevant obligations and partly by providing more clarity on how data handlers can verify what is qualified by the authorities as 'important data'.[257] The release of the draft, therefore, was seen as a signal from the Chinese Government that it is listening to businesses' concerns and is ready to take steps to address them. At the time of writing, companies are still waiting for these positive signals to be translated into action, to provide them with the clarity they need on how they can be compliant.

Five responses to risk: from doubling down to market exit

Most European Chamber members are committed to the Chinese market and have now begun to develop a variety of nuanced strategies for responding to risks. These strategies can broadly be organised into five categories, but they are not mutually exclusive – for example, a company may be doubling down on investment in one part of its business, while ring-fencing or even exiting in another.

Category / Behaviour	Moving business functions into China (onshoring supply chains or increasing investment)	Localisation (e.g., staff, IT and data infrastructure)	Moving business functions away from China (offshoring supply chains or shifting investments)
Doubling down	Yes	Yes	No or limited
Ring-fencing	Yes	Yes	Yes
Increased caution but business as usual	Limited	Limited	Limited
'China+1'	No	Limited	Yes
Market exit	No	No	Yes

- **Doubling down:** *Companies that are betting big on the China market despite, or in response to, growing risks*

This category includes those whose business model necessitates that they maintain a significant presence in China. Many of the largest investors in industries that are welcomed by the Chinese Government fall into this category.[258] Also in this category are those that view it as imperative to go big on China to remain globally competitive, either due to the size and dynamism of the Chinese market, or because they believe moving away from the market would leave a vacuum for domestic competitors to rush into and subsequently expand their market share. It also includes smaller players that are heavily invested in China, highly or fully localised, and lack the ability to diversify or pivot away from the market. *Examples: many of the largest MNCs, chemicals, automotive, SMEs that rely on China for manufacturing clusters and/or those that supply companies in Mainland China*.

A 'double-downer' on the risks of disconnecting from China

An executive from a large chemicals MNC noted that *not* being in the Chinese market is the biggest potential risk the company faces. They noted that the company learnt this lesson two decades ago, when it decided to invest in a plant in another Asian country, rather than build it in China. A Chinese competitor subsequently received support from the local authorities to develop a plant in the Chinese city that the European MNC had previously been considering and has since gone on to become the company's main global competitor. The executive noted, "This decision freed up market space to create a beast of our own making. We've since learned

257 *Notice of the Cyberspace Administration of China on the Public Solicitation of Comments on the Provisions on Regulating and Promoting the Cross-border Flow of Data (Draft for Comments)*, Cyberspace Administration of China, 28th September 2023, viewed 26th October 2023, <http://www.cac.gov.cn/2023-09/28/c_1697558914242877.htm>

258 European investment in China is highly concentrated with the ten largest investors collectively accounting for close to 80 per cent of the total value of European FDI in the country from 2017–2021. See: Kratz, Agatha; Barkin, Noah & Dudley, Lauren, *The Chosen Few: A Fresh Look at European FDI in China*, Rhodium Group, 14th September 2022, viewed 23rd November 2023, <https://rhg.com/research/the-chosen-few/>

our lesson and as a result continue to bet on China, despite the challenges of doing business increasing."

- **Ring-fencing:** *MNCs looking to isolate their China operations from their rest-of-world operations*

This group includes those whose business models require that they are highly localised, meaning they are relatively less reliant on developing and capitalising on global economies of scale to be competitive. It also includes companies that have a more limited footprint in the China market, as well as those that have the capacity to move parts of their operations away from China due to them having both the resources to do so and viable alternatives. *Examples: chemicals, industrial gases, digital and data, textiles*.

Case study of a 'ring-fencer's' risk management strategy

One executive at a company in the textiles industry noted it revised both its China investment and operational strategies as a result of the increased challenges of doing business in China. This change predates the COVID outbreak, taking place around 2017, and was predominantly due to their customers moving out of China to other Asian countries for cost reasons. In the years since, the company has reviewed its strategy again, as they concluded that politics was "increasingly trumping doing business in China". The company began accelerating and intensifying efforts to pursue an 'in China for China' strategy, while diversifying key functions away from the country—including its sourcing and production—which are geared towards serving customers outside of China. The company's strategy has multiple dimensions:

- **Flow of goods:** The company is encouraging customers that had previously been buying partially completed goods from its China subsidiary and then shipping them to other Asian markets for finishing, to buy directly from the group's other Asian subsidiaries. In tandem, it is also looking to 'attack' the Chinese market, by re-orientating existing capacity in China previously geared towards serving foreign customers and customers exporting from China, to Chinese companies selling into the China market.
- **Sourcing:** The company is adjusting its sourcing mix. From 2021 to 2023, the company reduced the amount of raw materials it imports into China from 20 per cent to five per cent, and is in the process of reducing the amount of raw materials that it imports from China to its overseas subsidiaries.
- **Investment:** From 2020 to 2023, the company invested in China roughly a third of what it invested from 2014 to 2017 in value terms. The nature of its investment has also shifted. As summarised by the interviewee, "We are now simply investing to replace any machinery that breaks in our factories in China, as well as to ensure we remain compliant with any new laws and regulations."
- **Financial:** The company is in the process of minimising the value of cash it keeps in China, for fear of being impacted by a sudden, drastic escalation of political tensions.
- **Reputational:** In response to high-profile consumer boycotts of Western textile and apparel companies operating in China, such as H&M,[259] the company now adopts a conservative approach when it comes to its marketing in China, and avoids disclosing that it is a foreign company.

- **Increased caution but business as usual:** *Companies that perceive the current risks are not yet acute enough to act on, or those that would like to act but lack alternatives*

This category includes companies that were impacted by the challenges that emerged since the beginning of the COVID-19 pandemic, but for whom doing business in China has largely returned to normal.[260] Companies operating in 'safe' segments of the economy, including those that have not been, or do not look set to be, impacted by either

259 In 2021, H&M was boycotted by Chinese consumers following it expressing concerns about alleged human rights abuses taking place in China's Xinjiang SAR. For a comprehensive summary of the H&M boycott, as well as other Chinese consumer boycotts of foreign brands which took place from 2008–2021, see: Viking, Bohman & Parup, Hillevi, *Purchasing with the Party: Chinese consumer boycotts of foreign companies, 2008-2021*, Swedish National China Centre, 11th July 2022, viewed 25th November 2023, <https://kinacentrum.se/en/publications/chinese-consumer-boycotts-of-foreign-companies/>

260 One example of this would be companies that previously experienced supply-chain challenges following the outbreak of the COVID-19 pandemic, but for whom such disruptions have eased, following China and the rest of the world fully reopening.

geopolitical tensions or policies geared towards promoting China's self-reliance also fall into this category.[261] Another group of companies that fall into this category are those that are experiencing increased challenges and risks to doing business in China, but cannot pivot, due to either a lack of alternative options or a lack of resources to do so. *Examples: companies in sustainability-related sectors, logistics, F&B, industrial inputs and machinery, SMEs.*

Business as usual, despite increasing concerns

Example one: A MNC that lacks options

One executive at a large European MNC, noted that in response to the rising challenges of doing business in China and the long-standing persistence of preferential treatment for domestic firms, the company has begun mapping out its critical dependencies on China, to identify alternative, non-Chinese suppliers. At the moment, the company's current ability to pivot away from China is limited due to there being a lack viable alternatives.

The interviewee noted, "The main change so far is our company's attitude. We're increasingly cautious about putting all our eggs in one basket and thinking, *what if?* Internal discussion has shifted from cost and efficiency to what the alternatives could be. If at some point there was another factory for the products we need outside of China, we would consider it."

Example two: A heavily localised SME

One executive at a small (100 to 250 employees) producer of niche, high-technology machinery noted that the company—which solely manufactures in China—had investigated setting up operations overseas, both in Europe and North America. This was prompted by concerns it could be impacted by escalating US-China strategic competition, due to both an expansion of the technical scope of US semiconductor export controls and the imposition of additional trade barriers as part of the trade war. However, the company ultimately took the decision to remain in China because the costs of leaving were prohibitively high. The interviewee noted that the company could not afford to relocate or shift parts of its operations, given that 90 per cent of its employees are concentrated in one city in China.

- **'China+1':** *Companies that are not looking for the exit, but that have the ability to increase resilience by identifying viable alternatives to China*

Companies adopting 'China+1' strategies predominantly include those that are not critically dependent on China for production or sourcing, and those whose operational models do not prevent them from easily relocating to other markets. It also includes those whose business models do not rely on sales into China, due to them using the country as a base for export, or because sales in China account for a negligible amount of their total revenues. This group excludes those with significant production or factories in China that cannot be easily replicated or relocated due to cost or technical considerations. *Examples: construction, consumer electronics and appliances.*

A construction company's 'China+1' strategy

One member company reported having revised its China operation's procurement and supply chain strategies in 2022, in direct response to the disruptions caused by China's 'zero-COVID' policy, as well as the fact that it came to feel ideology was taking precedence over economic concerns in China. The company has developed

261 In general, European companies that can bring technology needed to facilitate China overcoming technological bottlenecks or climb value chains are encouraged by Chinese state-planners to deepen their positions in China. Others operating in non-contentious segments of the economy are typically permitted to operate in the Chinese market. By contrast, those operating in contentious sectors of the economy, or sectors where the success of Chinese SOEs or national champions is seen as a priority—such as information and communication technology—often find themselves being squeezed out. For more information, see: *Decoupling: Severed Ties and Patchwork Globalisation*, European Chamber of Commerce in China, 14th January 2021, viewed 25th November 2023, <https://www.europeanchamber.com.cn/en/publications-decoupling>

a 'China+1' model, and is working to make its group's China subsidiary's operations detachable from its rest-of-world operations.

As part of this strategy, the company has begun identifying alternative, non-Chinese sources for key components and materials that it is currently completely dependent on China for, which are crucial for the running of its US and European operations. The company expects to have successfully done so within three years. By doing so, the company is not actively shifting away from its current Chinese suppliers, nor will it cease using Chinese materials, but rather is developing alternatives to enable it to quickly shift away from China in the event of a significant future disruption.

The company has also adjusted its investment strategy in China. While it continues to invest in China at roughly the same value as pre-COVID levels, it is not seeking to substantially increase its investment, which, given the size of the China market, remains relatively limited compared to the group's investments elsewhere. The company has also stopped looking into large acquisitions in China, which would be required to grow its market share. The company's CEO noted, "We are not looking to aggressively expand in China, and grow our footprint four or five times bigger. This would likely be possible, but doing so would require large investment which we are not willing to make in China, in case we need to urgently exit the market. This is a form of 'de-risking' for us and reflects the fact there is currently too much political and regulatory uncertainty."

- **Market Exit:** *Companies shifting parts or all of their operations out of China in response to regulatory or policy challenges, at a loss to their business*

This group includes companies operating in the most contentious or restricted sectors of China's economy, and whose ability to operate in China risks being suddenly impacted either by Western sanctions or export controls, or Chinese self-reliance-related policies. It also includes those that have experienced long-standing market access and regulatory barriers in China, which prevent their business from being viable in the long-term. *Examples: Semiconductors, IT and telecommunications, medical devices, renewables.*

Some companies reluctantly exit the market

Example one: Advanced manufacturing
One Chamber member noted their company's market share in China fell from around 35 to zero per cent over the course of a decade, due to the emergence of informal market barriers, forcing them to diversify away from the country. At the same time, the company remains reliant on importing parts and components from a network of over 500 Chinese suppliers for its rest-of-world operations, due to cost factors. The executive noted: "China has us in a geopolitical trap. We remain dependent on sourcing from China but we cannot sell to the market. We are investing elsewhere to diversify, but in practice this will take a long-time – maybe more than 10 years. A key challenge is that pricing mechanisms in Europe are so depressed that if we were to drop our Chinese partners today, we would not be able to sell at European auctions, due to us not being able to compete with the prices of Chinese players."

Example two: Advanced technology

According to another Chamber member, current Western technology export controls prevent it from providing its full product offerings in China. The executive noted this not only comes at a cost to the company, it is also concerned it will lose market share in the long-run due to domestic players filling the gap it leaves. In addition, the company is concerned that its China operations may experience further pushback from Chinese Government and/or business stakeholders, should it no longer be perceived as a 'reliable partner' due to it ceasing to sell certain products in China because of the ban.

Recommendations

Recommendations for China

- Align with the EU's approach of mitigating economic risks in a surgical and precise manner, and steer away from excessive self-reliance.
- Increase transparency when it comes to detailing the reasons for, and the commodities expected to be impacted by, actions that limit market access for risk-related reasons.
- Work with the EU to develop a common language on de-risking and to distinguish legitimate common-sense reasons for risk mitigation from protectionism.
- Develop nuanced strategies for strengthening supply chains that do not err towards trade protectionism.
- Refrain from erratic policy shifts, and seek consultation with business, allowing reasonable transition times before implementing changes to policies or regulations.
- Define 'local' clearly—when it is viewed as imperative that priority be given to 'local' players for security reasons—and ensure this definition is inclusive of foreign companies legally registered in China.
- Engage in dialogue with other governments and key stakeholders to depoliticise the business environment.
- Refrain from punishing companies for the actions of their home governments.
- Ensure access to data and business intelligence, which is vital for companies' investment decisions.
- Provide the conditions that allow companies to conduct independent, third-party audits of their operations so that they can be certified as being fully compliant with global legislation.
- Remain committed to globalisation and contribute to the strengthening of multilateral institutions.

Recommendations for the European Union

- Continue to adopt an approach to de-risking that is surgical and country agnostic, while defending EU core interests.
- Adopt a systemic and measured approach to reviewing European supply chains for critical inputs and the impact of various export control frameworks.
- Continue to proactively engage with China and reject calls for disengagement.
- Work with China to develop a common language on de-risking and to distinguish legitimate common-sense reasons for de-risking from protectionism.
- Enhance the overall coordination between member states and EU institutional stakeholders when it comes to de-risking, to foster a consistent, united approach.
- Coordinate with chambers of commerce, China-focussed think tanks, industry organisations, and businesses to map and discuss the realities experienced on the ground when it comes to de-risking, including the challenge and limitations faced, as well as what is required to facilitate corporate risk management in critical areas.
- Strengthen the competitive capabilities of European players by developing bottom-up industrial policies that promote market competition and innovation in strategic industries, without prescribing technological pathways.

Recommendations for European businesses

- Develop in-house capabilities to better anticipate changes to legislation and increased political risk, as well as to fully understand the costs associated with increased localisation into / disconnection from the China market.
- Maintain strong communication between company HQs and China operations, to ensure that HQs receive accurate, on-the-ground information in order to make informed investment and operational decisions.
- Benchmark your company against other foreign players in relation to their own risk management approaches to better understand if and how you may be impacted by legislative and geopolitical developments.
- Conduct detailed supply chain reviews and risk assessments to gauge the impact of potential legislative developments on your supply of critical inputs, and prepare accordingly.

- Expand the scope of your due diligence efforts to determine the level of exposure of your suppliers and customers to potential shocks and what this could mean for your operations.
- Monitor areas of potential political risk or public backlash, or sudden changes in market conditions, and develop proportionate mitigation strategies.
- Prepare for emerging global regulations on supply chains by establishing transparency up- and downstream to the greatest extent possible, and determine levels of exposure to current and potential sanctions.
- Invest and participate more in government advocacy efforts through chambers of commerce, industry associations and standard-setting bodies.
- Engage with the EU and member state governments to help outline the key concerns, opportunities and challenges faced by European businesses when it comes to risk management.

APPENDIX

A. China's risk management as part of six structural transition processes in China's political economy

China's approach to economic security and risk management can be understood as one of six structural transition processes [结构性过程]:[262]

Figure 11: China's pursuit of 'high-quality development' taking place amid six structural transition processes

Key structural transitions	Key policy goals	Key issues	Key policies
Economic transition and industrial upgrading	• Transition to innovation-based economy • Climb industrial value chain • Digitalisation and decarbonisation	• Low service sector contribution to GDP • Manufacturing struggling at mid-end products, low industrial value-added	• *Made-in-China 2025* • *Opinions on High-quality Development of Service Industry 2019* • *14FYP 2021 Ch. 8, 10.*
Market-orientated reforms	• Institutional transition • Factor of production liberalisation • SOE reform and supply-side structural reform	• Low total factor productivity • Lower efficiency of state capital • Monopolies and overcapacity	• *Building Market-Orientated System for Allocation of Factors 2020* • *14FYP 2021 Ch. 19-22.*
Economic globalisation	• Integration into global flow of goods, services, capital, talent and ideas • Continued opening-up	• Comparatively weak trade in services • Comparatively low outbound FDI stock • Geopolitics and decoupling policies	• *14FYP 2021 Ch. 40* • *Opinion on Increasing Efforts to Attract Foreign Investment 2023*
Domestic demand system	• Consumption-boosting policies • Business environment policy • Rebalancing of public investments	• Low consumption share of GDP • Demographic shift to ageing population • Imperfect social security system	• *14FYP 2021 Ch. 12-14.* • *Strategic Plan for Fully Expanding Domestic Demand 2022*
Social rebalancing and market governance	• Equality and poverty reduction • Social fairness and protection • Balanced regional development	• Inequality: top 1% holds 30% of wealth • Vulnerability of social groups (e.g., youth) • Disorderly expansion of capital	• *14FYP 2021 Ch. 23-32.*
Economic security	• Coordinate development and security	• Import dependencies, supply chain risks • China's weaker geoeconomic power • Systemic financial risks	• *14FYP 2021 Ch. 41-42, 52-53*

Longer-term transitions *Trade-off / rebalancing processes*

China moved from linear economic development model of 'reform and opening up' under Deng to dealing with strategic trade-offs

B. "Holistic National Security"

Looking at the 'security' element of the "coordinate development and security" concept, the policy basis for China to look at security comprehensively is the "holistic view of national security" [总体国家安全观]. It was first introduced by Xi Jinping during the first plenary of a newly founded National Security Commission in 2014, and subsequently elevated into the CCP's constitution at the 19th Party Congress in 2017. This marked a significant milestone in China's ideology building, as it was the first attempt to create an overarching concept to respond to the comprehensive risks perceived to be emanating from a gradually deteriorating external environment. Overall, 16 security concepts have been codified as part of the "holistic view of national security".

262 This compares to a similar analytical framework in: Wang, Yong, *New Opportunities and Challenges for China's Industrial Upgrading in the 14th Five-Year Plan Period: A New Structural Economics Perspective*, International Economic Review, 2021(01), pp. 56-75.

Based on public information

Figure 12: "Holistic View of National Security": 16 concepts, 7 more relevant to business[1)2)]

1	**Political Security** • Regime, political system and ideology security • Key policy maker: MSS	9	**Technology Security** • Complete S&T system / threat of external S&T advantages / sustainability • Key policy maker: MOST
2	**Military Security** • No military invasion and threat of war / ability to maintain security • Key policy maker: CMC, MOD	10	**Ecological Security** • Threat to ecological environment / ability to deal with major problems • Key policy maker: MEE, MOA, MNR
3	**Territorial Security** • Territorial integrity, national unity, maritime rights • Key policy maker: MOT	11	**Resource Security** • Obtain natural resources reliably and economically • Key policy maker: State Council, NDRC
4	**Economic Security** • Economic development / sustainable and healthy growth • Key policy maker: State Council, NDRC, MIIT, MOFCOM	12	**Nuclear Security** • Safety measures for nuclear facilities and materials • Key policy maker: MEE, NNSA
5	**Cultural Security** • Internal and external threats to culture / maintain continued security • Key policy maker: CPD, MOE, MCT	13	**Overseas Interests Security** • National interests, e.g., maritime passages, overseas citizens • Key policy maker: MFA
6	**Biological Security** • Ability to respond to risks and threats related to biological factors • Key policy maker: MOST	14	**Outer Space Security** • Use of space resources / respond to threats / maintain space interests • Key policy maker: MOD
7	**Cybersecurity** • Prevent attacks, intrusions, interference, illegal use on network/data • Key policy maker: CAC, NDRC	15	**Deep Sea Security** • Exploration / safe access / scientific studies / international cooperation • Key policy maker: MNR, MOST
8	**Societal Security** • Public security, criminal, terrorist incidents and mass incidents • Key policy maker: MPS, MCA	16	**Polar Security** • Exploration / safe access / scientific studies / international cooperation • Key policy maker: MNR, MOST

Business-relevant concepts

1) MSS = Ministry of State Security; CMC = Central Military Commission; MOD = Ministry of Defence; MOT = Ministry of Transport; NDRC = National Development and Reform Commission; MIIT = Ministry of Industry and Information Technology; MOFCOM = Ministry of Commerce; CPD = Central Propaganda Department; MOE = Ministry of Education; MCT = Ministry of Culture and Tourism; MOST = Ministry of Science and Technology; CAC = Cybersecurity Administration of China; MPS = Ministry of Public Security; MCA = Ministry of Civil Affairs; MEE = Ministry of Ecology and Environment; MOA = Ministry of Agriculture; MNR = Ministry of Natural Resources; NNSA = National Nuclear Safety Administration
2) 1-3: 'Traditional' security concept / 4-16: 'Non-traditional' security concept

Among all 16 codified security concepts, seven have more direct relevance to European businesses' engagement with and in the Chinese market: 1) political security; 2) territorial security; 3) economic security; 4) biosecurity; 5) cyberspace security; 6) science and technology (S&T) security; and 7) resource security.

The other concepts, however, may also trigger risk management policies that could impact business sectors in China. For instance, 'cultural security' shapes media content, which is frequently subject to review to avoid it looking 'over-Westernised' or 'culturally colonised'. Plus, there can be an impact more broadly on how foreign business communicates and engages in public affairs in China.

C. China's 'bottleneck' technologies

Following the US Department of Commerce's 2018 ban of Chinese telecommunication equipment giant ZTE, aimed at preventing it from using American components, the official newspaper of the China's MOST, the *Science and Technology Daily*, published a series of articles pointing out technologies that are especially exposed to foreign—in particular American—sanctions or other policy instruments. These so-called 'bottleneck' technologies are numerous and are prevalent in several different sectors, from industrial machines, like milling cutters, to key industrial components, like semiconductors and aviation-grade steel. In total, thirty-five 'bottleneck' technologies have been identified as being at the heart of China's recent risk management policy focusing on key/core technology breakthroughs.

Figure 13: 'Bottleneck' technologies: High-tech decoupling is real, albeit only a "small yard" for now

China's 35 tech 'chokepoints' listed by state media	US policy tools					China policy tools	
	Export control	Investment restriction	Import restriction	Industrial policy	Overall[1] intensity	Responses/catch-up efforts	Catch-up[2] progress
Photolithography machines	◕	●	○	◕	●	• Export control on critical minerals	◑
Microchips	◕	●	●	●	●	• Diversified supply, self-development	◑
Operating systems	◕	●	◕	◑	◕	• Self-development	◑
Aircraft engine nacelles	●	●	◔	◔	◑	• Diversified supply, joint R&D (e.g., RUS)	◑
Touch sensors	◑	◑	◔	◔	◑	• Diversified supply, self-development	◔
Vacuum evaporators	◔	◔	◔	◔	◔	• Tech introduction, self-development	◔
High-end RF components	◕	●	●	◕	●	• Public R&D support	◑
iCLIP Primers and reagents	◕	◑	◑	●	◕	• Diversified supply, self-development	○
Heavy-duty gas turbines	●	●	○	◔	◑	• Diversified supply, FIEs localisation	◕
LiDAR	◕	◕	◕	◔	◕	• Export control on LiDAR	●
Airworthiness standards	◔	N/A	N/A	N/A	◔	• Introduction of FAA standards	◑
High-end capacitor resistors	◕	◑	◔	◔	◑	• Diversified supply, self-development	◔
Electronic Design Automation	◕	●	◔	◕	●	• Diversified supply, self-development	◔
Indium-tin-oxide sputtering targets	◔	○	◔	◔	◔	• Public R&D support	◕
Algorithms for robotics	◑	◕	◕	◕	◕	• Tech introduction via international M&A	◔
Aviation-grade steel	◕	◕	○	◔	◑	• Self-development	◔
Milling cutters	◔	○	○	◔	◔	• Tech introduction, public R&D support	◑
High-end bearing steel	◔	◔	◑	◔	◔	• Public R&D support	●
High-pressure piston pumps	◑	◑	◑	◔	◑	• Tech introduction, self-development	◕
Aviation design software	◑	◕	○	◑	◑	• Self-development	◔
High-end photoresist	◕	●	◔	◕	◕	• Self-development	◔
Common-rail fuel injection	◔	○	◔	◔	◔	• 'Buy China' support, self-development	◕
Transmission electron microscopes	◑	◑	◔	◑	◑	• N/A	○
Main bearings for tunnel boring machines	◔	◔	◔	◔	◔	• Diversified supply, joint R&D	◑
Microspheres	◔	◑	◑	◑	◑	• Tech introduction, self-development	◑
Underwater connectors	◑	◑	○	◔	◔	• Diversified supply, public R&D	◔
Key materials for fuel cells	◑	◑	○	●	◕	• Export control on critical minerals	◔
Welding power sources	◔	◔	○	◔	◔	• Public R&D support	◕
Lithium battery separators	◑	◕	◔	●	◕	• Public R&D support	●
Components for medical imaging equipment	◕	◑	◔	◕	◕	• Tech introduction via international M&A	◑
Ultra-precision polishing	◕	◑	◑	◕	◕	• Diversified supply, self-development	◔
Epoxy (for carbon fibre)	◕	●	●	◕	●	• Diversified supply, self-development	◔
Stainless steel for rockets	◕	●	◕	●	●	• Public R&D support	◔
Database management sys.	◑	◔	◑	◔	◑	• Self-development	◕
Scanning electron microscopes	◑	◔	◔	◑	◑	• Public R&D support	◔

1) US policy intensity is measured by presence of certain technology (or related entities) in major lists of US restrictive tools;

2) In rating China's catch-up process, 1/4 HB = tech breakthrough made, 2/4 = commercialised, 3/4 = domestically competitive, 4/4 = globally competitive

Figure 13 provides a high-level overview of the intensity of US' instruments across four different policy dimensions—export controls, investment restrictions, import restrictions and industrial policy—and how they impact China's access to thirty-five 'bottleneck' technologies.[263] China's ensuing policy response, as well as assessment of its progress in catching-up to the technological frontier, is also presented. It indicates that the US' restrictions are especially concentrated on technologies used for microelectronics and avionics.

For instance, photolithography machines, which are essential for the production of high-end chips, fall under export control measures, notably the military end-user list and commerce control list, while also being subject to investment restrictions through the CFIUS and Office of Foreign Assets Control. More recently, biotechnologies, such as medical imaging equipment, and green technologies, such as lithium battery separators, have also been subject to high regulatory scrutiny.

263 A list of 35 'bottleneck' technologies was published by *S&T Daily*, a semi-official media under the MOST, in 2018.

The PRC's past responses to these restrictions have tended to focus on advancing domestic production and technological capabilities, as well as diversifying its supply. Indeed, whereas export controls have been imposed by Chinese authorities on certain technologies, notably LiDAR radar systems, the policy response in regard to 'bottleneck' technologies has largely been aimed at either expanding domestic capacity through R&D and preferential procurement of domestic products, or diversifying its supply base. In addition, direct import restrictions appear not to have been imposed for these bottleneck technologies. While this reflects China's reliance on foreign imports in bottleneck technologies, it also suggests a deliberate effort to manage risk through key/core technology breakthroughs and building self-reliance.

Abbreviations

AI	Artificial Intelligence
API	Active Pharmaceutical Ingredient
BCS	Business Confidence Survey
BIL	Bipartisan Infrastructure Law
BIS	Bureau of Industry and Security
CAC	Cyberspace Administration of China
CAS	Chinese Academy of Science
CCP	Chinese Communist Party
CFIUS	Committee on Foreign Investment in the United States
CNY	Chinese Yuan
COVID-19	Coronavirus disease 2019
CSDDD	Corporate Sustainability Due Diligence Directive
CSDP	Common Security and Defence Policy
CSIS	Center for Strategic and International Studies
CSL	Cybersecurity Law
CSRD	Corporate Sustainability Reporting Directive
DSL	Data Security Law
DUV	Deep Ultraviolet
ECI	European Critical Infrastructure
EESS	European Economic Security Strategy
EO	Executive Order
EU	European Union
EUV	Extreme Ultraviolet
FCC	Federal Communications Commission
FDI	Foreign Direct Investment
FYP	Five-year Plan
G7	Group of Seven (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States)
GFC	Global Financial Crisis
HS	Harmonised System
ICT	Information and Communication Technology
IMF	International Monetary Fund
IP	Intellectual Property
IRA	Inflation Reduction Act
IT	Information Technology
JV	Joint Venture
MCF	Military-civil Fusion
MERICS	Mercator Institute for Chinese Studies
MIIT	Ministry of Industry and Information Technology
MLP	National Medium- and Long-term Plan for the Development of Science and Technology (2006–2020)
MOFCOM	Ministry of Commerce
MOST	Ministry of Science and Technology
MSS	Ministry of State Security
NDRC	National Development and Reform Commission
NEV	New Energy Vehicle
NPC	National People's Congress
OEM	Original Equipment Manufacturer

PIPL	Personal Information Protection Law
PPE	Personal Protective Equipment
PRC	People's Republic of China
REE	Rare Earth Element
S&T	Science and Technology
SEI	Strategic Emerging Industry
SIAC	Single Intelligence Analysis Capacity
SMEI	Single Market Emergency Instrument
TTC	Trade and Technology Council
UNCTAD	United Nations Conference on Trade and Development
US	United States
USD	United States Dollar
USTR	United States Trade Representative
WTO	World Trade Organization

ABOUT CHINA MACRO GROUP

China Macro Group (CMG) is an innovative European boutique consultancy specialised in original, fact-based and calibrated China research and analysis to advise European business and financial investors with a focus on management issues shaped by China's evolving political economy and geoeconomic developments, ranging from strategy, footprint / organizational design, HQ-subsidiary interactions to strategic partnerships and negotiations. In that, CMG seeks to effectively integrate the four analytical lenses of business administration, market, public policy and international affairs.

Against the backdrop of China's distinct political system and its stated pursuit for continued socio-economic development towards a 'modern, technologically advanced, and prosperous country' by the middle of the century, CMG conceptualises China's 'socialist market economy' as a political economy that is concurrently undergoing six structural transitions, namely: an economic transition and industrial upgrading, market-oriented reforms, economic globalisation, 'domestic demand system', social rebalancing and market governance, and economic security. This conceptualisation enables CMG to better calibrate its advice on corporate strategies and management decisions of high materiality and look at longer time horizons.

CMG is a professional service provider that puts clients first and makes big strides to tailor its services to complex client needs, contribute complementarily to existing expertise and interact effectively with headquarters in Europe and subsidiaries in China. CMG strives for its services to be value-adding, and to offer creative and practical consulting contributions to the decision-making of European business. It is partnership-led and cross-cultural on all levels, and draws on talent that combines independent, analytical and rigorous thinking with relevant thematic expertise and a strong command of the Chinese language. Currently, CMG operates with presences in Munich, Zurich and Beijing and engages with partners, stakeholders and media on topics of common interest to contribute to public discussion and augment the quality of China analysis that matters.

Visit www.chinamacro.eu to learn more about CMG's values, services, research insights, team and career options.

European Chamber
中国欧盟商会

ABOUT THE EUROPEAN UNION CHAMBER OF COMMERCE IN CHINA

The European Union Chamber of Commerce in China (European Chamber) was founded in 2000 by 51 member companies that shared a goal of establishing a common voice for the various business sectors of the EU and European businesses operating in China. It is a member-driven, non-profit, fee-based organisation with a core structure of 26 working and 9 fora representing European business in China.

The European Chamber now has more than 1,700 members in seven chapters operating in nine cities: Beijing, Nanjing, Shanghai, Shenyang, South China (Guangzhou and Shenzhen), Southwest China (Chengdu and Chongqing) and Tianjin. Each chapter is managed at the local level by local boards reporting directly to the Chamber's Executive Committee.

The Chamber is recognised by the European Commission and the Chinese authorities as the official voice of European business in China. It is registered as a foreign chamber of commerce with the Ministry of Civil Affairs.

The European Chamber is part of the growing network of European Business Organisations, which connects European business associations and chambers of commerce from more than 50 non-EU countries around the world.

Principles:

- We are an independent, non-profit organisation governed by our members.
- We work for the benefit of European business as a whole.
- We operate as a single, networked organisation across Mainland China.
- We maintain close, constructive relations with the Chinese and European authorities, while retaining our independence.
- We seek the broadest possible representation of European business in China within our membership: small, medium and large enterprises from all business sectors and EU Member States throughout China.
- We operate in accordance with Chinese laws and regulations.
- We treat all of our members, business partners and employees with fairness and integrity.

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