



Rethinking the UK’s relationship with China: How to address key challenges to British economic security posed by the nascent superpower

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Introduction

This research paper looks at the implications of China's growing centrality to the world economy for British economic security. It argues that while the country's rapid rise has created benefits and new opportunities for engagement, the commercial and trade policies it pursues also pose risks that demand an astute policy response.

All aspects of Chinese political life are dominated by the Chinese Communist Party (CCP), which is not democratically elected in a national vote and rejects multiparty rule.¹ Freedom of expression is restricted – the press and internet are both heavily censored – and Chinese citizens lack a range of rights we take for granted in the UK.² In recent years, the CCP has demonstrated a reluctance to adhere to the norms of free trade and an increased assertiveness on the international stage.

In China, the West now has 'a global rival that is politically antithetical to liberal values'.³ It is vital that Britain does not mishandle the consequences of economic interaction with this new superpower to its own detriment.⁴ Policymaking in this area should be forward-looking, strategic, and protect British interests against harmful or disadvantageous practices. It must not be unduly driven by a myopic focus on short-term economic gains.⁵ This paper identifies a range of challenges posed by China and sets out a number of high-level policy proposals to guide future legislative and governmental action.

While the particular focus of this paper is China, many of its main themes – the importance of national resilience and of securing Britain's place as a leading high-tech hub in an increasingly competitive international environment, for example – are of broader relevance. The government's 'Integrated Review of Security, Defence, Development and Foreign Policy' was released in March 2020.⁶ It represents the most comprehensive assessment of British foreign policy in a generation and establishes the enhancement of our technological capabilities and preparedness for supply chain disruptions as core objectives. We might therefore expect significant attention to be paid to these concerns in the months and years ahead.

¹ 'Xi Jinping praises CPC rule, says multiparty democracy promotes competition', https://www.business-standard.com/article/international/xi-jinping-praises-cpc-rule-says-multiparty-democracy-promotes-competition-118030500674_1.html

² 'China 2019', <https://www.amnesty.org/en/countries/asia-and-the-pacific/china/report-china/>

³ S. Patterson, *China, Trade and Power: Why the West's Economic Engagement has Failed* (2018)

⁴ S. Patterson, *China, Trade and Power: Why the West's Economic Engagement has Failed* (2018)

⁵ 'Understanding UK Strategic Dependence on Chinese Investment: The Case for 'Partial Decoupling'', <https://www.civitas.org.uk/content/files/China-Independence-1.pdf>

⁶ 'Global Britain in a Competitive Age: The Integrated Review of Security, Defence, Development and Foreign Policy', <https://www.gov.uk/government/publications/global-britain-in-a-competitive-age-the-integrated-review-of-security-defence-development-and-foreign-policy>

Economic Overreliance on China

China's unprecedented growth

The scale of Chinese development in recent decades has been staggering. A 2019 report for the US Congress summarises this well:

‘Since opening up to foreign trade and investment and implementing free-market reforms in 1979, China has been among the world’s fastest-growing economies, with real annual gross domestic product (GDP) growth averaging 9.5% through 2018⁷, a pace described by the World Bank as “the fastest sustained expansion by a major economy in history.” Such growth has enabled China, on average, to double its GDP every eight years and helped raise an estimated 800 million people out of poverty.’⁸

China became the world’s largest exporter in 2009, the world’s leading trading nation in goods in 2013,⁹ and is projected to become the world’s biggest economy by 2028.¹⁰

Chinese investment in Europe has risen correspondingly. Of the approximately one third of European Union (EU) total assets in the hands of foreign-owned, non-EU companies, 9.5 per cent are under Chinese, Hong Kong or Macau-based ownership, a jump of 7 per cent since 2007. Chinese direct investment is concentrated in the major EU economies with the UK seeing the most between 2000-2018, receiving over 20 per cent more than Germany (the second highest EU recipient).¹¹

UK trade with China has also increased markedly. In 1999, it was the UK’s 26th largest export market and 15th largest source of imports. In 2019, it was the UK’s sixth largest export market and fourth largest source of imports.¹² UK exports to China were worth just under £31bn in 2019, while imports from China were £49 billion, meaning the UK runs a trade deficit of around £18.3 billion.

⁷ The COVID-19 pandemic has since led to a global economic slump. Despite this, China reported 2.3% GDP growth for 2020, meaning it will be the only G20 economy to post GDP growth for that year.

Source: ‘China’s GDP growth beat estimates. What does it mean for 2021?’, <https://www.fmmagazine.com/news/2021/jan/china-gdp-growth-2021.html>

⁸ ‘China’s Economic Rise: History, Trends, Challenges, and Implications for the United States’, <https://www.everycrsreport.com/reports/RL33534.html#:~:text=the%20global%20economy,-Since%20opening%20up%20to%20foreign%20trade%20and%20investment%20and%20implementing,sustained%20expansion%20by%20a%20major>

⁹ ‘China and the world: Inside the dynamics of a changing relationship’, <https://www.mckinsey.com/~/media/mckinsey/featured%20insights/china/china%20and%20the%20world%20inside%20the%20dynamics%20of%20a%20changing%20relationship/mgi-china-and-the-world-full-report-june-2019-vf.ashx>

¹⁰ ‘China set to surpass U.S. as world’s biggest economy by 2028, says report’, <https://www.cnbc.com/2020/12/26/china-set-to-surpass-us-as-worlds-biggest-economy-by-2028-says-report.html>

¹¹ ‘How much of Europe does China own?’ <https://www.bbc.co.uk/news/world-47886902>

¹² ‘Statistics on UK trade with China’, <https://commonslibrary.parliament.uk/research-briefings/cbp-7379/#:~:text=In%202019%3A,6.8%25%20of%20all%20UK%20imports>

For over twenty years, the idea that rapid economic progress and greater prosperity would lead to the adoption of a more liberal, democratic political system in China was influential in guiding Western policy and behaviour. Such attitudes underpinned the Clinton administration's push to allow China's accession to the World Trade Organization (WTO) in 2001,¹³ a monumental event in Chinese history¹⁴ and a move that Britain supported. In 2005, former Prime Minister Tony Blair referred to the 'unstoppable momentum' towards greater freedom in the country.¹⁵

However, while access to the world market ushered in an era of unprecedented development in China, it has not resulted in the liberal-democratic political shift that many had anticipated and hoped for. In fact, some analysts believe its enhanced economic strength has enabled it to 'deepen its authoritarian behaviour at home, and its confidence in advancing its interests in its region and beyond'.¹⁶ This necessitates a commensurate adjustment in British strategic thinking.

Strategic dependency

A 2020 report by the Henry Jackson Society, a security think tank, analysed international trade statistics to determine the extent of 'strategic dependency' on China among members of the Five Eyes (an intelligence alliance comprised of the UK, USA, Australia, New Zealand and Canada). Defining strategic dependency as existing 'when a country is a net importer of a particular good, it imports more than 50% of its supplies from China, and China controls more than 30% of the global market of that particular good',¹⁷ it found that the Five Eyes are strategically dependent on China across 831 categories of goods; 229 in the UK's case.

The findings are striking, highlighting the scope of the UK's dependency on China across a broad range of sectors and the potential vulnerability of Western nations to supply chain interruptions. As the world's largest producer of active pharmaceutical ingredients and health-related products China is central to our medicinal supplies; the UK is dependent on it for chemicals such as phenylacetic acid (used in a range of drugs), chloramphenicol (an antibiotic), and compounds used in paracetamol and anti-viral medicines, to name but a few examples. In 2018, it produced 80 per cent of all magnesium and magnesium compounds – vital for industries such as construction, transport, IT supplies and a range of other industries, and classified as a 'critical material' by the US.

Sixty-one per cent of mobile phones used in the UK are produced in China as are a high percentage of key industrial products ranging from safety glass to steel-capped boots, chemicals for disinfectants, and a wide variety of other goods and products vital to strategic industries. These issues are not of concern to Five Eyes powers alone – as of March 2020 more

¹³ President Clinton even suggested it was a step towards achieving President Woodrow Wilson's dream of 'a world full of free markets, free elections and free peoples working together.'

¹⁴ 'What Happened When China Joined the WTO?', <https://world101.cfr.org/global-era-issues/trade/what-happened-when-china-joined-wto>

¹⁵ 'Blair presses for China democracy', http://news.bbc.co.uk/1/hi/uk_politics/4218080.stm

¹⁶ 'After the Golden Age: Resetting UK-China Engagement', <https://bfpg.co.uk/wp-content/uploads/2020/07/BFPG-Report-July-2020-FINAL-4.pdf>

¹⁷ 'Breaking the China Supply Chain: How the 'Five Eyes' can Decouple from Strategic Dependency', <https://henryjacksonsociety.org/wp-content/uploads/2020/05/Breaking-the-China-Chain.pdf>

than four out of five companies worldwide relied to at least some extent on Chinese suppliers.¹⁸

China is not averse to resorting to economic coercion. In light of the above statistics, this tendency is of real significance. An article by the Centre for Strategic and International Studies describes how:

‘Beijing has used the threat and imposition of trade-restrictive measures to punish over a dozen countries for pursuing policies deemed harmful to Chinese interests. The first episode occurred in 2010 when China blocked salmon imports from Norway after the Nobel Committee awarded the Peace Prize to Chinese human-rights activist Liu Xiaobo. That same year, Chinese customs officials obstructed exports of rare earths to Japan in an effort to compel Tokyo to release the captain of a Chinese fishing trawler who was detained after his vessel collided with Japanese coast guard vessels in waters near the disputed Senkaku Islands. In 2012, after engaging in a confrontation with China at Scarborough Shoal in the South China Sea, the Philippines discovered that its tropical fruit exports to China were quarantined due to alleged infestation.’¹⁹

The CCP’s decision in mid-2020 to place a tariff of 80.5 per cent on Australian Barley imports from China, and to impose an import ban on Australian beef exports from four major abattoirs, is another widely publicised example of such behaviour.²⁰ This was in part a response to an Australian push for an independent inquiry into China’s handling of Covid-19 in April 2020 which angered the Chinese authorities. Mongolia, New Zealand, Sweden, Taiwan and the UK are among the other nations that have been on the receiving end of punitive Chinese economic measures.²¹

Openness is important and beneficial, but one eye should be kept on the potential risks that dependence on a strategic competitor entails, particularly where that competitor has in the past shown a willingness to take economic action against countries that question its policies. In this context, British policymakers should think carefully about the degree of economic reliance on China that it is wise to tolerate where critical infrastructure is concerned.

Potential overexposure to Chinese investment

The UK is a recipient of substantial Chinese investment. This brings advantages but is not entirely risk-free.

A Civitas report notes that:

¹⁸ ‘After the Golden Age: Resetting UK-China Engagement’

¹⁹ ‘Time for a Collective Pushback against China’s Economic Coercion’, <https://www.csis.org/analysis/time-collective-pushback-against-chinas-economic-coercion>

²⁰ ‘Red-meat processors have beef sales to China suspended as trade barriers escalate’, <https://www.abc.net.au/news/rural/2020-05-12/china-trade-escalation-as-beef-farmers-are-targeted/12237468>

²¹ ‘Time for a Collective Pushback against China’s Economic Coercion’

'the UK was the second largest recipient of Chinese foreign direct investment (FDI) in Europe by volume in 2019, mostly due to Chinese-enterprise acquisitions of additional stakes in a data firm worth £1.8 billion. It also topped the list of European countries for the number of single transactions involving Chinese entities. Since 2000, the UK is reported to have attracted the most Chinese FDI in the EU by far, with a cumulative volume of €50.3 billion over that period, compared to €22.7 billion for Germany, the second-ranked country.'²²

The CCP has a central role in many aspects of China's economic life, and CCP officials play a part in the management of many Chinese companies.²³ Given the significant percentage of Chinese firms with CCP-links, and the often-opaque nature of such links, high levels of Chinese investment into the UK are of strategic importance. As one journalist put it, 'Chinese domestic laws and administrative guidelines, as well as unspoken regulations and internal party committees, make it quite difficult to distinguish between what is private and what is state-owned.'²⁴

Concerns around Chinese access to and involvement in areas of critical and sensitive infrastructure, such as security, energy and telecommunications networks, have risen to the fore of late. The most high-profile example in a British context was the political debate surrounding the decision to involve Huawei, a Chinese company, in the development of the UK's 5G mobile network. The Chinese firm is the world's second largest smartphone maker and is accused of having links to the CCP.²⁵ Its founder was a member of the Chinese army and remains a member of the CCP.²⁶

The US has suggested that the company's equipment could be used by China for spying and has banned American firms from doing business with it.²⁷ Australia and New Zealand have followed suit. Having initially decided to let Huawei play a key role in the UK's 5G networks the government changed track, announcing measures to remove the company from the country's 5G network. A parliamentary inquiry subsequently found 'clear evidence of collusion' between Huawei and the CCP.²⁸

China's involvement in the UK's energy sector has also faced scrutiny. Ministers voiced unease at the approval of the Chinese State-owned General Nuclear Power Corporation (CGN) as a key source of funding for a range of new nuclear projects, including the multi-billion dollar power facility at Hinkley Point C as well as Sizewell C and Bradwell B.

²² 'Understanding UK Strategic Dependence on Chinese Investment: The Case for 'Partial Decoupling''

²³ 'Chinese Capitalism is an Oxymoron', <https://www.nationalreview.com/magazine/2019/05/20/chinese-capitalism-is-an-oxymoron/>

²⁴ 'We Can't Tell if Chinese Firms Work for the Party', <https://foreignpolicy.com/2019/02/07/we-cant-tell-if-chinese-firms-work-for-the-party/>

²⁵ 'Huawei: MPs claim 'clear evidence of collusion' with Chinese Communist Party', <https://www.bbc.co.uk/news/technology-54455112>

²⁶ 'Huawei: Why is it being banned from the UK's 5G network?' <https://www.bbc.co.uk/news/newsbeat-47041341>
<https://www.bbc.co.uk/news/newsbeat-47041341>

²⁷ 'Huawei: Why is it being banned from the UK's 5G network?'

²⁸ 'Huawei: Why is it being banned from the UK's 5G network?'

Initially agreed under the Cameron government in 2015, Prime Minister Theresa May subsequently ordered that the deal with CGN be re-examined on security grounds in 2016, before ultimately approving it. But unease with the situation persists. In 2018, then US assistant secretary for international security and non-proliferation, Christopher Ashley Ford, told the UK that Washington had evidence that CGN was converting civilian technology for military use and advised against the partnership.²⁹ One MP, Ian Duncan Smith, has suggested China is not a 'trusted vendor', and recommended a review of the nuclear contracts.³⁰

Heightened awareness of potential security concerns around Chinese investment has resulted in a push to tighten controls on foreign investment internationally. EU legislation to coordinate screening of foreign investment came into force in October 2020, and member states are implementing national legislation in accordance with this framework.³¹ The new mechanism allows the European Commission to give an opinion when an investment 'threatens the security or public order' of more than one member state or undermines an EU-wide project.³² Member states are also encouraged to review any 'state-supported investments in sensitive technologies and critical infrastructure' – which Hanemann, Huotari and Kratz (2019) estimate would have included 82 per cent of Chinese mergers and acquisitions in the EU in 2018.³³ On a state level, several European governments are updating, establishing, or are in the process of establishing, foreign investment screening regimes.³⁴

In the US, the Committee on Foreign Investment in the United States (CFIUS) assists the president in reviewing the national security aspects of foreign investment. In 2018, the Trump administration and members of congress enacted the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) aimed at bolstering the foreign investment review process under CFIUS, in large part in response to concerns around Chinese FDI.³⁵ This is set to continue to be closely scrutinised under the Biden administration.³⁶

Steps towards a new foreign investment regime have been taken in the UK as well. In November 2020, the National Security and Investment Bill (NSIB) was introduced by ministers. It establishes mandatory pre-screening for deals involving foreign investments in sensitive sectors such as artificial intelligence (AI) and defence (it is currently a voluntary notification

²⁹ 'China tensions raise doubts over UK nuclear projects', <https://www.ft.com/content/9d0d3a75-d3f4-4cab-9176-be582140987c>

³⁰ 'China tensions raise doubts over UK nuclear projects'

³¹ 'Responding to the China challenge: The state of play on investment screening in Europe', <https://ecfr.eu/article/responding-to-the-china-challenge-the-state-of-play-on-investment-screening-in-europe/>

³² 'How much of Europe does China own?'

³³ 'Chinese FDI in Europe: 2018 Trends and Impact of New screening Polities', https://merics.org/sites/default/files/2020-04/190311_MERICs-Rhodium%20Group_COFDI-Update_2019.pdf

³⁴ 'Chinese FDI in Europe: 2018 Trends and Impact of New screening Polities'

³⁵ 'Congressional Research Service: The Committee on Foreign Investment in the United States (CFIUS)' <https://fas.org/sgp/crs/natsec/RL33388.pdf>

³⁶ 'Biden is reportedly beefing up the national security panel CFIUS to scrutinize Chinese investment in US tech startups', <https://www.businessinsider.com/biden-china-policy-cfius-investors-national-security-tech-startups-wsj-2021-1?r=US&IR=T>

process) and enables the government to call investment transactions in for a review where it is believed they might pose a national security risk.³⁷

Made in China 2025

Through various sweeping state-led initiatives, most notably the ‘Made in China 2025’ industrial plan (MIC 2025), the CCP is seeking to make China a global leader in the manufacture and development of advanced technology. Launched in 2015, MIC 2025 is a vast 10-year programme of reforms intended to rapidly update the country’s productive base. It aims to turn China into a ‘manufacturing superpower’, and ‘challenge the economic primacy of the current leading economies and international corporations’ in this area.³⁸

The plan fits within a longer-term attempt by the CCP to transition away from overreliance on low wage, high volume manufacturing (at present mining, energy and consumer goods such as clothing and footwear make up almost half of the country’s economy)³⁹ towards highly productive advanced industries. By 2035, China hopes to lead innovation in specific industries and set global standards, and by 2049 (the 100th anniversary of the founding of the People’s Republic of China) it aims to have cemented its position as the world’s most dominant manufacturing power.⁴⁰

MIC 2025 accelerates the development of ten key sectors, listed as:

- New information technology
- High-end numerically controlled machine tools and robots
- Aerospace equipment
- Ocean engineering equipment and high-end vessels
- High-end rail transportation equipment
- Energy-saving cars and new energy cars
- Electrical equipment
- Farming machines
- New materials, such as polymers
- Bio-medicine and high-end medical equipment⁴¹

Together, these cover almost all high-tech industries central to economic growth in developed economies.

³⁷‘New Framework for Foreign Investment Screening in the U.K.: A Primer on the National Security and Investment Bill’,

<https://www.faegredrinker.com/en/insights/publications/2020/11/new-framework-for-foreign-investment-screening-in-the-uk-a-primer-on-national-security-and-inves>

³⁸ ‘Made in China 2025: The making of a high-tech superpower and consequences for industrial countries’,

<https://merics.org/sites/default/files/2020-04/Made%20in%20China%202025.pdf>

³⁹ ‘Is ‘Made in China 2025’ a Threat to Global Trade?’, <https://www.cfr.org/backgrounder/made-china-2025-threat-global-trade>

⁴⁰ ‘Made in China 2025’ Industrial Policies: Issues for Congress’

⁴¹ ‘Made in China 2025’ plan issued’,

http://english.www.gov.cn/policies/latest_releases/2015/05/19/content_281475110703534.htm

MIC 2025 was initially quite warmly received in the UK policy environment. Leading UK trade authorities not only focused on moving UK industrial facilities to China but on promoting Chinese investment into the UK. The China-Britain Business Council and UK Trade & Investment for example both took steps to highlight the advantages and opportunities that the UK might derive from it, and in late 2017 Rona Fairhead – the then UK Minister for Trade and Export Promotion – said, ‘The UK and China are natural partners when it comes to industrial growth. We see Made in China 2025 as a perfect opportunity for manufacturers from both countries to work together to drive forward our trading relationship’.⁴²

However, more recently there has been a shift in British policy circles towards a greater recognition of the challenge MIC 2025 presents, with a number of MPs suggesting the UK needs to change direction.⁴³ As one report put it, MIC 2025 is changing ‘the terms of the game’.⁴⁴ The figures involved are immense, with Chinese central and local governments pledging hundreds of billions of dollars in funding in the form of subsidies, low interest loans, tax incentives and other types of support to encourage foreign firms to set up operations in China, according to some estimates.⁴⁵ Its international dimension includes the accelerated global acquisition of high-tech companies by Chinese investors, partly supported and guided by the state.⁴⁶

It is important that due attention is paid to the methods the CCP plans to use to achieve its goals. According to a US congressional report, they:

‘appear to involve large subsidies, protection of domestic industries, directed policies to purchase technology and IPR from abroad, increased pressure on foreign firms to transfer technology in order to do business in China, and what appears to be a goal of deliberately reducing foreign participation in China’s markets.’⁴⁷

This alteration to the international economic landscape prompted U.S. Trade Representative Robert Lighthizer to state that the MIC 2025 initiative was ‘a very, very serious challenge, not just to us, but to Europe, Japan and the global trading system.’⁴⁸

MIC 2025 is set to have a profound impact on world trade. It is likely to create new opportunities for trade and growth, but also presents a complex new set of mid-to-long term challenges that should not be ignored. It requires a clear-sighted strategic response.

⁴² ‘UK-China summit explores collaboration for Made in China 2025 and UK industrial strategy’, <https://www.gov.uk/government/news/uk-china-summit-explores-collaboration-for-made-in-china-2025-and-uk-industrial-strategy>

⁴³ ‘China’s rulers aren’t those we partnered with a decade ago’: Foreign Affairs Committee Chairman TOM TUGENDHAT says it’s time to confront the reality we’ve ignored for too long’, <https://www.dailymail.co.uk/debate/article-9129891/Chinas-rulers-arent-partnered-decade-ago-says-TOM-TUGENDHAT.html>

⁴⁴ ‘Made in China 2025: The making of a high-tech superpower and consequences for industrial countries’

⁴⁵ http://docs.dpaq.de/12007-european_chamber_cm2025-en.pdf

⁴⁶ ‘China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces’, http://www.iberchina.org/files/2016/MadeinChina_2025_merics.pdf

⁴⁷ China’s Economic Rise: History, Trends, Challenges, and Implications for the United States’

⁴⁸ <https://www.youtube.com/watch?v=L03Np5ZLvM8>

Contentious Economic Practices

The 'Reciprocity Gap'

While Chinese investors have traditionally enjoyed largely unfettered access to Western markets – in which they are generally afforded the same rights as Western companies – this has not always been true of non-Chinese investors into China. Foreign investment in Chinese markets is heavily restricted, feeding a growing perception that China has chipped away at the principle of reciprocity built into the post-second world war economic order.

A report by the Rhodium Group and the Mercator Institute for China Studies (the RHG Report) found that this 'reciprocity gap' includes restrictions on market entry for foreign companies (who are prevented from investing in certain sectors), as well as 'formal and informal discrimination post market entry (i.e. companies can invest but face disadvantages operating in China compared to Chinese-owned companies).'⁴⁹ Though reforms aimed at opening up the regulatory environment have been introduced in recent years China remains one of the world's most restrictive economies for foreign companies across a wide range of sectors including fisheries, media, communications, transport, financial services and many others. Companies that do successfully enter the market encounter barriers that are not faced by local firms. Over half of all European companies in the country report being treated more unfairly than Chinese companies, ranging from unequal application and enforcement of laws and regulations to more informal discrimination.⁵⁰

This reciprocity gap causes imbalances in foreign investment and allows China to exploit the openness of market economies in Europe and the United States. Based on an analysis of all Chinese takeovers with a value of USD 1 billion or more in the period from 2000 to 2017, the RHG Report authors found that:

'one quarter of those deals could not have legally been possible in the other direction at the same time as foreign investment in those sectors was prohibited or restricted. In half of the instances, the transactions would have been legally permissible but highly unlikely to be approved because of state control, industrial policies and other factors. In other words, roughly three out of four of the largest Chinese acquisitions in Europe since 2000 could not have happened the other way around.'⁵¹

They conclude this contributes to 'major imbalances and distortions in capital flows between China and Europe and causes real harm to European businesses and consumers.'⁵²

The result of this protectionism is a distortion of free competition. Inefficient or unproductive Chinese firms are shielded from failure when challenged by more innovative and efficient foreign competitors. Indeed, state backing means they may even defeat such companies,

⁴⁹ 'Chinese FDI in Europe: 2019 Update', <https://merics.org/sites/default/files/2020-05/MERICSRhodium%20GroupCOFDIUpdate2020.pdf>

⁵⁰ 'EU-China FDI: Working towards more reciprocity in investment relations', <https://merics.org/en/report/eu-china-fdi-working-towards-more-reciprocity-investment-relations>

⁵¹ 'EU-China FDI: Working towards more reciprocity in investment relations'

⁵² 'EU-China FDI: Working towards more reciprocity in investment relations'

leading to industry consolidation by protected players that would otherwise have struggled in the free market.

Intellectual Property

There is an increasing recognition of the problem of Chinese intellectual property theft and drainage. In 2017, the US Commission on the Theft of American Intellectual Property concluded that China is 'the world's principal IP infringer'.⁵³ A number of high-profile think tank reports have been released in recent years seeking to shift greater focus onto the issue.

Much of the concern in this area relates to the potential susceptibility of university research collaborations to abuse by the CCP. Such collaborations offer many benefits – both financial and academic – however they may also create risks. Worried that universities are vulnerable, MI5 and GCHQ have both warned universities to put national security before commercial interest.⁵⁴

A report for Civitas by Tylecote and Clark (2021) looked at the possible exploitation of scientific research by the CCP. It found there is 'a pervasive presence of Chinese military-linked conglomerates and universities in the sponsorship of high-technology research centres in many leading UK universities and in their research relationships.'⁵⁵

Tylecote and Clark argue that:

'in many cases...UK universities are unintentionally generating research that is sponsored by and may be of use to China's military conglomerates, including those with activities in the production of Weapons of Mass Destruction, including intercontinental ballistic missiles as well as hypersonic missiles, in which China is involved in a new arms race and seeks 'massively destabilising' weaponry...'

The report finds that 'over half of the 24 Russell Group universities and many other UK academic bodies have or have had productive research relationships with Chinese military-linked manufacturers and universities'.⁵⁶ It concludes that existing methods by which the UK monitors Chinese involvement in university research are inadequate. A paper by King's College London and the Harvard Kennedy School likewise found that 'the UK needs to do a better job of measuring, managing and mitigating risks [in the higher education sector] that are at present poorly understood and monitored.'⁵⁷

⁵³ China is the "world's principal IP infringer": US watchdog', <https://m.economictimes.com/news/international/business/china-is-the-worlds-principal-ip-infringer-us-watchdog/articleshow/57376881.cms>

⁵⁴ 'Security services fear the march of Beijing's spies on universities', <https://www.thetimes.co.uk/article/security-services-fear-the-march-of-beijings-spies-on-universities-wf93f9vrq>

⁵⁵ 'Inadvertently Arming China?: The Chinese military complex and its potential exploitation of scientific research at UK universities', <https://www.civitas.org.uk/publications/inadvertently-arming-china/>

⁵⁶ 'Inadvertently Arming China?: The Chinese military complex and its potential exploitation of scientific research at UK universities'

⁵⁷ 'The China question: Managing risks and maximising benefits from partnership in higher education and research', <https://www.kcl.ac.uk/policy-institute/assets/china-question.pdf>

Similar issues exist in the commercial sphere too. Chinese investors and companies, often with state backing, have been encouraged to invest in foreign firms in an attempt to gain access to their IP. Foreign companies have also highlighted the use of state-sponsored forced technology transfers – contractual terms that require they enter into joint ventures and share IP and technology with Chinese firms – as a condition for doing business or investing in China.^{58 59} A survey conducted by the US-China Business Council in 2015 for example found that 59 percent of foreign firms operating in China were worried about transferring technology to China.⁶⁰

Quantifying the exact scale of the problem is hard (China denies one exists at all),⁶¹ but most evidence points to the fact that such practices remain relatively commonplace.⁶² This is a contravention of free trade norms, and source of tension between China and its trade partners.

Recommendations

Nurture Britain's high-tech capabilities

Science and technology are progressing at an extraordinary pace. This is now a key locus of competition between states, a dynamic that is only set to intensify in the digital age. Britain's ability to position itself as a world-leader in high-tech fields will be central to its long-term prosperity and security. This should be made a core policy priority. As MIC 2025 demonstrates, China has hegemonic ambitions in this area – it is important to stay ahead of the game.

Britain is one of the most innovative countries in the world,⁶³ this could be capitalised upon to ensure the country remains at the forefront of scientific and technological research and development. Doing so would help safeguard UK national security interests in the coming decades, as well as attracting investment, accelerating economic growth, and enhancing productivity more broadly.

⁵⁸ 'Forced Technology Transfer', <https://www.investopedia.com/forced-technology-transfer-fft-4687680>; <https://piie.com/commentary/op-eds/section-301-us-investigates-allegations-forced-technology-transfers-china>

⁵⁹ 'Section 301: US Investigates Allegations of Forced Technology Transfers to China', <https://piie.com/commentary/op-eds/section-301-us-investigates-allegations-forced-technology-transfers-china>

⁶⁰ 'Growth Continues Amidst Economic Slowdown, Rising Competition, Policy Uncertainty', https://www.uschina.org/sites/default/files/USCBC%202015%20China%20Business%20Environment%20Member%20Survey_0.pdf

⁶¹ 'China rejects U.S. accusations on technology transfer as baseless at WTO', http://www.xinhuanet.com/english/2018-05/29/c_137213238.htm

⁶² 'Forced Tech Transfers Are on the Rise in China, European Firms Say', <https://www.wsj.com/articles/forced-tech-transfers-are-on-the-rise-in-china-european-firms-say-11558344240>

⁶³ <https://www.great.gov.uk/international/content/invest/how-to-setup-in-the-uk/research-and-development-rd-support-in-the-uk/>

Safeguard critical sectors and industries

The avoidance of import and supply-chain dependency on China in certain critical sectors should be prioritised.

In their report for the Henry Jackson Society, Rogers et al. propose that the UK undertake ‘a national review of strategic industries to identify and prioritise those that require protection from dependency on China’.⁶⁴ This is a logical starting point and could be used to inform future legislative action and cooperation with democratic allies to this end.

There appears to be governmental support for such an approach. In May 2020, the press reported that Prime Minister Boris Johnson had ‘ordered civil servants to draw up plans codenamed Project Defend to end Britain’s reliance on China for vital medical supplies and other strategic imports in light of the coronavirus crisis.’⁶⁵ As part of this project, officials have been asked to identify the country’s key economic vulnerabilities to potentially hostile foreign governments.⁶⁶

Ensure Chinese foreign investment is appropriately screened

The UK is a leading recipient of Chinese foreign investment. A recent study found that more than 115 British companies have been partly or wholly acquired by Chinese-owned companies in the past decade.⁶⁷ Civitas research suggests a significant percentage (possibly up to 80 per cent) of Chinese foreign investment has come from Chinese state-owned or CCP-linked sources.⁶⁸ UK aviation, energy, defence, semi-conductor, data and finance companies are among those that have been invested into. This has clear security implications.

It is important that this investment is adequately scrutinised. An increased awareness of this fact has been a key driver behind the introduction of numerous investment screening mechanisms internationally in the past few years. As described above (see ‘Potential overexposure to Chinese investment’), in response to a surge in investments by Chinese firms into strategic sectors the EU has introduced legislation to coordinate screening of FDI. The US has implemented even tougher measures including by strengthening CFIUS’ powers to review FDI. Japan and many other developed nations have taken similar steps.⁶⁹

Despite the scale of investment into the UK, the nature of that investment has not historically been subject to much scrutiny by British public authorities. The publication of the NSIB is set to change this. This is a step in the right direction. Investment screening is a key mechanism

⁶⁴ ‘Breaking the China Supply Chain: How the ‘Five Eyes’ can Decouple from Strategic Dependency’

⁶⁵ ‘Boris Johnson wants self-sufficiency to end reliance on Chinese imports’, <https://www.thetimes.co.uk/article/boris-johnson-wants-self-sufficiency-to-end-reliance-on-chinese-imports-bmlxnl8jl>

⁶⁶ ‘Boris Johnson wants self-sufficiency to end reliance on Chinese imports’,

⁶⁷ ‘Chinese have swooped on 115 UK firms in a decade, Henry Jackson Society think tank finds’, <https://www.thetimes.co.uk/article/chinese-have-swooped-on-115-uk-firms-in-a-decade-henry-jackson-society-think-tank-finds-00hzd63zl>

⁶⁸ ‘Understanding UK Strategic Dependence on Chinese Investment: The Case for ‘Partial Decoupling’’

⁶⁹ ‘Japan tightens rules on foreign stakes in 518 firms, citing national security’, <https://www.reuters.com/article/us-japan-investment-mof-idUSKBN22K0Z0>

through which the government should seek to square the circle of free trade and national security. It can be used to help ensure the UK's openness is not exploited, while also maintaining the country's identity as a 'global champion of free trade and an attractive place to invest'.⁷⁰

Counter IP theft, espionage and drainage

The government should establish robust mechanisms to protect IP relating to critical infrastructure from theft or co-option by Chinese entities. It should also oppose state-sponsored 'forced' technology transfer in the corporate space using the diplomatic means and trade remedies outlined below.

It is vital that steps are taken to ensure the university sector is alert to – and vigilantly guards against – the possibility of IP theft, especially of IP relating to strategically important areas such as defence technology and AI. Too many risks and blind spots exist in the current higher education system in this respect.

There are benefits to drawing Chinese students and academics to the UK, and to international research collaboration. Attracting students from abroad can generate economic advantages, and foreign-born individuals working with British researchers make many crucial contributions to the country's worldwide technological and scientific standing.⁷¹ But the current set-up is open to exploitation. Comprehensive measures should be adopted to guard against and the abuse of research relationships by the CCP.

Make effective use of diplomatic pressure and trade remedies permitted by WTO rules

Britain should pursue efforts to close the 'reciprocity gap' by pushing back against unfair and anti-competitive Chinese trading practices such as restrictions on foreign companies doing business in China, subsidies, forced IP transfers and so on. A new UK agency is being established by the Trade Bill: The Trade Remedies Authority.⁷² The government should begin to use it, alongside diplomatic means, to address these issues and influence the Chinese government. Britain should also work with its liberal allies to pressure China into meeting its international commitments by filing cases in the WTO. While there are limits to what WTO dispute settlement can achieve, China has proven reasonably willing to comply with complaints brought against it in the past.⁷³

⁷⁰ 'New powers to protect UK from malicious investment and strengthen economic resilience', <https://www.gov.uk/government/news/new-powers-to-protect-uk-from-malicious-investment-and-strengthen-economic-resilience>

⁷¹ 'The China question: Managing risks and maximising benefits from partnership in higher education and research'

⁷² 'The UK's New Trade Remedies Regime', <https://www.allenoverly.com/en-gb/global/news-and-insights/publications/the-uks-new-trade-remedies-regime>

⁷³ 'Disciplining China's Trade Practices at the WTO: How WTO Complaints Can Help Make China More Market-Oriented', <https://www.cato.org/policy-analysis/disciplining-chinas-trade-practices-wto-how-wto-complaints-can-help-make-china-more>

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