

Sailing the Seas of Economic Security



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1. Introduction

Mathieu Duchâtel

2. China as a Security State, the Economic Security Dimension

Marcin Przychodniak

3. Supply Chain Resilience: China's Search for Vertical Integration

Francesca Ghiretti

4. Europe's Turn to Economic Security: Does It Really Matter?

Mathieu Duchâtel and Pierre Pinhas

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Sailing the Seas of Economic Security

In the security State that Xi Jinping is building, economic security matters. But in the “*securitization of everything*”¹ that is emblematic of his governing style, how crucial is it exactly? Economic security is just one of the 16 areas outlined in Xi’s 2014 “*comprehensive national security*” (总体国家安全). This concept encompasses a broad range of issues, from culture to “*ecological security*”. When he first introduced the notion at the founding session of the Central National Security Commission, Xi Jinping called economic security the “*foundation*” of China’s comprehensive approach.² As such, it ranked below the “*bedrock*” (根本) – “*political security*” –, which centers on preserving China’s regime stability. Among the other elements listed, military and technological security are meant to provide an “*assurance*” (保障) to that overarching goal. The remaining domains, such as deep sea and space, are areas where the Party-State aims to defend Chinese interests from threats.

China’s “*comprehensive national security*” concept was first articulated in 2014, during a critical juncture in Xi Jinping’s first term at the top of the Politburo Standing Committee, when his national security prioritization started becoming obvious. Since then, China’s international environment has considerably deteriorated, largely as a pushback against Xi’s policies. A factor behind this deterioration is **the rise of economic security agendas in the United States, Japan, Europe and the Republic of Korea, which complicates Chinese national and corporate strategies to expand internationally**. Most countries’ strategies do not explicitly mention China, a fig-leaf approach referred to by the EU as “*country-agnostic*”. The US uses the designation “*countries of concern*”³ (China, North Korea, Iran and Russia) to ensure “*malign actors do not have access to cutting-edge technology that can be used against America and our allies*”.

¹ Katja Drinhausen and Helena Legarda, “‘Comprehensive national security’ unleashed: How Xi’s approach shapes China’s policies at home and abroad”, MERICS, September 15, 2022, <https://www.merics.org/en/report/comprehensive-national-security-unleashed-how-xis-approach-shapes-chinas-policies-home-and>

² “中央国家安全委员会第一次会议召开习近平发表重要讲话 (The first meeting of the Central National Security Commission was held and Xi Jinping delivered an important speech)” Government of the People’s Republic of China, April 15, 2014, https://www.gov.cn/xinwen/2014-04/15/content_2659641.htm

³ Sujai Shivakumar, Charles Wessner and Thomas Howell, “Guardrails’ on CHIPS Act funding to restrict investments in China may restrict participation in CHIPS Act incentives”, Center for Strategic and International Studies, September 20, 2023, <https://www.csis.org/blogs/perspectives-innovation/guardrails-chips-act-funding-restrict-investments-china-may-restrict>

Whether these policies openly state it or hide it behind diplomatic language, they all respond to the same risks: China's excessive leverage resulting from its investment in critical infrastructure and its importance in many supply chains, which creates options for economic coercion or the restriction of access to critical raw materials; leakage of civilian technology that ends up in military projects; and a list of issues linked to an uneven playing field with China's state-led economy, and its powerful industrial policies.

Economic security is hotly debated in the European Union.⁴ Some argue that by securitizing economic relations with China, the Commission is gaining excessive power at the expense of EU national governments. Others criticize an overly defensive posture, with risks for the European single market, and question the extent to which the European Commission's agenda is driven by the United States.

There is little public debate in China about the notion, except in the area of supply chain resilience.

By contrast, **there is little public debate in China about the notion, except in the area of supply chain resilience.** Naturally, no one can contest the absolute priority placed on "political security" and the designation of "economic security" as a tool for achieving it. Framing "economic security" from the outset as it relates to regime stability sidesteps questions raised in the West, especially the central difference between a narrower EU approach prioritizing military technologies,

coercion, and excessive leverage versus a broader approach favored by US and Japan, centered on economic competitiveness.

Xi Jinping's absolute priority on national security reflects the Party's assessment that the "period of strategic opportunity", previously emphasized by all Chinese leaders since Deng Xiaoping, has now come to an end, replaced by a period of "changes unseen in a century". In Xi Jinping's "New Era", one might add that the **top priority has shifted from the prosperity of the Chinese people to a quest for state power on the global stage.**

With clearly established strategic priorities, the space for policy debate lies in how to pragmatically implement efficient policies. China undoubtedly faces supply chain challenges, brought to light by US semiconductor restrictions. The solution to this? "Vertical integration", where major market players leverage their size to build a self-reliant supplier network, or at least one with reduced disruption risks. Here, companies are the implementers of a strategy designed by the Party leadership. In addition, **Chinese views seem to favor public stockpiling of critical raw materials, an approach often dismissed in Europe as a costly waste of resources.**

When it comes to relations with the EU, Chinese commentaries depart from "de-risking is just decoupling in disguise" line, as goes a now famous Xinhua commentary.⁵ Since 2022, there has been a flurry of diplomatic activity to numb the European de-risking agenda. It culminated with the Germany visit of Chinese Prime Minister Li Qiang, who in the presence of German top companies executives, rejected "de-risking" and called

⁴ Mathieu Duchâtel and François Godement, "Europe's economic security and China: where to draw the line", Institut Montaigne, September 4, 2023, <https://www.institutmontaigne.org/en/expressions/europes-economic-security-and-china-where-draw-line>

⁵ Xinhua Commentary: "De-risking is just decoupling in disguise", Xinhua, May 26, 2023, <https://english.news.cn/20230526/f534dc97c66f43e98b1a7642d07221c8/c.html>

for all parties to adopt instead a "*dialectical approach to view the dependence issue and avoid[ing] making simple equivalences between interdependence and insecurity*".⁶

The message here is that the two sides are able to co-manage the dependence risks they pose to each other. **What goes unmentioned is the asymmetry in the decision-making process that leads to imposing costs** – China under Xi Jinping has a well-established record of economic coercion, while the EU anti-coercion instrument, newly adopted in October 2023, of all diplomatic options before the EU can resort to defensive retaliatory measures.⁷

Chinese signals are somewhat contradictory. On the one hand, China uses top foreign leaders' visits to Beijing to secure public statements against decoupling. On the other hand, China welcomes the European rejection of decoupling, and focuses on managing the concrete challenges that the EU's de-risking policies

will continue to pose to EU-China interactions. **There seems to be an understanding that European moves are rational and justified.** After all, Europe remains incredibly more open to China than the opposite.

In sum, China seeks to minimize the European "*de-risking*" agenda and promote its own national-security-first approach in EU-China trade and investment relations. This is essentially what the Chinese Ambassador to the EU, Fu Cong, says when he argues that: "*in our view, dependency is not dangerous. What is dangerous is to weaponize the dependency. If the EU has the political will to alleviate their concerns, China is ready to talk to them and come to some sort of agreement. We should not weaponize the dependencies that one side may have on the other*".⁸ China, however, weaponizes dependencies and rushes to reduce its own reliance on foreign suppliers. While this statement may be insufficient to build trust, it nevertheless has the merit of underlining **China's diplomatic tactic of downplaying the problem.**

⁶ Cao Desheng, "Li Qiang rejects rhetoric of 'de-risking' or 'reducing dependence'", *China Daily*, June 20, 2023, <https://global.chinadaily.com.cn/a/202306/20/WS649102b7a310bf8a75d6ad53.html>

⁷ Mathieu Duchâtel, "Effective deterrence? The coming European anti-coercion instrument", *Institut Montaigne*, December 12, 2022, <https://www.institutmontaigne.org/en/series/europe-and-economic-coercion>

⁸ Fu Cong, "Transcript of Ambassador Fu Cong's Interview with the *New Statesman*", *Mission of the People's Republic of China to the European Union*, May 28, 2023, http://eu.china-mission.gov.cn/eng/mh/202305/t20230528_11084886.htm



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China as a Security State, the Economic Security Dimension

After more than five years of increasingly open rivalry with the US (starting from President Trump's term in office), two years of the coronavirus pandemic (and the "zero-Covid" policy), and less than a year after the start of the Russian invasion of Ukraine, the issue of national security remains at the center of the Chinese political debate – both in political, military and economic terms. The Chinese Communist Party's (CCP) dominant conviction is that the period of "strategic opportunity" (战略机遇) and "peace and development" (和平与发展), that had emerged in the early 1990s and given China the chance of unfettered development, has come to an end. And as noted by Xi Jinping during his March visit to Moscow, we are witnessing "a change unseen in 100 years". Such a vision can also be found in the various signals sent by the report of the 20th National Congress of the CCP.¹

In the view of Chinese authorities, a **political reorientation from a priority on growth to a priority of protecting key interests and "national security"** (国家安全) is needed. Such an approach has both objective reasons (the Chinese economy's problems and the stressful international situation) and

subjective reasons (the attempt to maintain social legitimacy and stability within the CCP).

A political reorientation from a priority on growth to a priority of protecting key interests and "national security" (国家安全) is needed.

In this context, the national security-first approach is characteristic of Xi Jinping's reign, as the People's Republic of China (PRC) Chairman and the Party's General Secretary. The promotion of the "Chinese Dream", a concept he coined himself in 2013, has ceased. Under new circumstances, the pursuit of prosperity and a comfortable life for the Chinese people requires a concerted effort to protect and strengthen the security of the State. A particular component of this concept, especially in the context of technological sanctions imposed by the US and deteriorating relations with the EU, is **economic security**. It is **understood in China as giving the authorities guarantees for the development of the**

¹ "Hold high the great banner of socialism with Chinese characteristics and strive in unity to build a modern socialist country in all respects – Report at the Twentieth National Congress of the Communist Party of China (高举中国特色社会主义伟大旗帜 为全面建设社会主义现代化国家而团结奋斗 — 在中国共产党第二十次全国代表大会上的报告)", The People's Republic of China, October 25, 2022, https://www.gov.cn/xinwen/2022-10/25/content_5721685.htm

PRC's military, technological potential, with a focus on political power at home and abroad.

What kind of national security?

Defining national security and developing procedures for protective actions was at the heart of the National Security Law (NSL)'s enactment by the Standing Committee of National People's Congress in 2015.² Already the first article mentioned that it was adopted to safeguard the power of "people's democracy" (人民民主) and the socialist system with Chinese characteristics. These measures include the elimination of internal and external threats to state power (and *de facto* the preservation of the current political system, of which the CCP's power monopoly is the defining element), along with the sovereignty, the unity and the territorial integrity of China. But the measures also included the living standards of its citizens as well as the sustainable economic and social development of the country. **The scope of security itself is also, according to the law, very broad** – it indicates that the goal of the State organs and the legislature is a state of "people's security" (人民安全), which should also probably be interpreted as a concept synonymous with people's democracy. Political and economic security are crucial in the optics of the PRC authorities'. As identified in the "comprehensive national security" (总体国家安全) concept, they should thus be "guaranteed" by China's military, cultural and social might.

The scope of security itself is also, according to the law, very broad.

Parts of the provisions of the 2015 law were included in the report published following the 20th Congress. Section eleven directly indicates the need to modernize the national security system, including by stabilizing the social sphere. Hereafter, the PRC authorities emphasized the importance of improving socio-economic conditions as an essential element of national security, and therefore the political system's stabilization, including against the backdrop of the Party's retention of power. In the context of economic hardships, the **dichotomy between social expectations (also present within intra-Party debates) and the ability of the authorities to shape these expectations is therefore at the center of CCP concerns**. The main dilemma remains the appropriate redirection of social activity (but also of the dynamics of action within the CCP itself) towards protecting the State from both internal and external threats. At the same time, effectively safeguarding against negative impacts of foreign restrictions, de-globalisation and protectionist mechanisms are inevitable. As the report mentions, "China adheres to the right course of economic globalization" (中国坚持经济全球化正确方向).

The post-Congress report repeats most of the defining elements of the "national security" concept outlined in the NSL. However, it adds new elements – first and foremost, the unchallenged primacy of the CCP's leadership and monopoly on decision-making. In addition, it expands the concept's scope to food security or military capacity-building activities outside the PRC – by also linking them to relations with other partners, including through power projection beyond its borders. The report points out the need to strengthen the capacity of public institutions to act in this regard, but above all the need to mobilize the public (and the Party apparatus) in "difficult times". It invokes mass control by referring to the so-called *Fengqiao* experience (枫桥经验), a means to prevent any anti-Party declarations

² "National Security Law of the People's Republic of China (Presidential Decree No. 29) (中华人民共和国国家安全法(主席令第二十九号)", National People's Congress, July 1st, 2015, https://www.gov.cn/zhengce/2015-07/01/content_2893902.htm

while also maintaining the vigilance of CCP officials and the Chinese public.

The elements in the report, as well as in the NSL, are being pushed through top-down public debates that include academics, analysts and party media personnel. This is especially true for the PRC's economic security, the most sensitive element in China-US relations. In Chinese debates, economic security **is therefore understood both actively (as an action to obtain new opportunities) and passively (as securing already existing assets in China**, such as electromobility technology or the export of rare earths). Economic security becomes part of the implementation of a strategy of national rejuvenation and the development of modern technology (in the middle of an ongoing fourth technological revolution, which China sees as its first ever chance to "win" against the US), but also a strategy to secure existing Chinese assets in the event of Western sanctions (American, but also Dutch or Japanese).

The concrete essence of economic security

In the pursuit – like Marxists characterisation of revolution – of economic security, the State has certain responsibilities. It should strive to preserve the economic system and the socialist economy, to establish institutional mechanisms for preventing and resolving economic risks and to ensure the stability of key sectors, industries, infrastructure and construction projects, while not neglecting the financial system.

The PRC's declaratively market-oriented but realistically protectionist **economic policy is**, in this context, **a reflection of the principles derived from the NSL and specified in the report of the 20th Congress**. It is moreover an expression of Chinese authorities' research of a narrative regarding China's development

and GDP decrease, but also about the exhaustion of existing sources of growth. The changes of the CCP's 19th Congress (later replicated during sessions of the Chinese Parliament or meetings of the CCP Politburo) included, among others, the so-called "dual economy" concept, a narrative focused on the middle class' needs, and anti-speculative motives regarding the property market. In addition to strict foreign policy motivations, economic security also encompasses export restrictions that China imposed in August 2023 on gallium and germanium. These restrictions were put in place in response to a perceived threat from deliberate external actions against its economy.

Economic policy is, in this context, a reflection of the principles derived from the National Security Law and specified in the report of the 20th Congress.

In this regard, Ma Baocheng, Director and Professor of the Emergency Management Training Center of the Central Party School, expresses a somewhat "softer" view of possible measures for economic security.³ In addition to classic references to provisions of the post-Congress report, he further refers to the *communiqué* following the CCP Central Committee Politburo meeting of November 2021. At that time, resilience to "crises coming from outside" was identified as an important component of economic security. From this point of view, **priority is given to systemic financial problems, food, energy and mineral security, infrastructure, as well as the protection of interests outside China**. Ma Baocheng thus exposes inevitable challenges facing Chinese authorities: improving trade relations with the

³ Ma Baosheng, "Key tasks for modernizing China's national security system and capacity (推进国家安全体系和能力现代化的重点任务)", *People's Daily*, February 10, 2023, <http://www.rmlt.com.cn/2023/0210/665709.shtml>

US or, for example, restructuring public debt. Broadly introducing necessary priorities, he largely calls for caution and precaution in action rather than for offensive and active policies – especially when it comes to foreign relations.

In *Qiushi*, a good source to get the pulse of current ideological trends in the CCP, Cai Jue and Dong Xiahui, members of a theoretical research center of the National University of Defense Technology, elaborate even further on the nature of economic security in terms of modern technology.⁴ Writing about “*key core technologies*” (关键核心技术) and quoting Xi Jinping, they point out that these cannot be acquired (or rather bought from outside), but should come from the Chinese people's own work as a product of their innovation. They point out that their acquisition and exclusiveness are crucial to build the State's global capacity, but also its security.

The two researchers further emphasize the need for an autonomous approach and an almost selfishness from China in this regard to try and reduce dependency on foreign contacts. Both authors point to 5G, robotics, or lasers as spaces, where the PRC has previously succeeded in key future technologies. The new decisive sectors are oil and gas, basic raw materials, high-end chips, industrial software, crop seeds, instruments and equipment for scientific experiments, and chemical preparations. Hence, **despite believing that there are existing problems to diffuse innovation within these industries, Cai and Dong consider there is a growing need to give full play to the government's organizational role in the research of key core technologies.**

Cai and Dong consider there is a growing need to give full play to the government's organizational role in the research of key core technologies.

As for Wang Yiming, Vice Chairman of the China Center for International Economic Exchanges, he seeks to reconcile “*water*” with “*fire*” when presenting the challenge of “*keep[ing] national security [as] a priority*” while increasing relations and openness with the global economy.⁵ This would allow China to build a new platform for international cooperation and support its economy. The author refers to the global trends of promoting relocation (“*friendshoring*” and “*nearshoring*”) as the main threats for China's economic security. The article is in this regard a reference to a new type of globalization that, while trying to maintain the liberal nature of the global market, would concretely serve Chinese interests.

Finally, Yao Zhizhong, a Researcher from the Institute of World Economics and Politics of the Chinese Academy of Social Sciences, directly refers to the challenges listed in the post-20th Congress report, calling the PRC's situation a “*period where strategic opportunities, risks and challenges coexist and risk factors increase*” (战略机遇与风险挑战并存且风险因素增多期).⁶ Yao remains optimistic about chances for China's economy and economic security. However, measures are needed to balance

⁴ Cai Jue and Dong Xiahui, “Strive to keep key core technologies in your own hands (努力把关键核心技术掌握在自己手中)”, *Qiushi*, May 25, 2023, http://www.qstheory.cn/dukan/hqwq/2023-05/26/c_1129646716.htm

⁵ Wang Yiming, “Building a new higher-level open economic system (建设更高水平开放型经济新体制)”, *China Center for International Economic Exchanges*, July 31st, 2023, <https://www.cciee.org.cn/Detail.aspx?newsId=20649&TId=684>

⁶ Yao Zhizhong, “How to understand the strategic opportunities, risks and challenges China faces (如何认识中国面临的战略机遇和风险挑战)”, *Aisixiang*, June 6, 2023, <https://www.aisixiang.com/data/143955.html>

and accelerate comprehensive, coordinated and balanced economic and social development. Namely, the key tests are narrowing the urban-rural development gap, guaranteeing environmental protection and ecology, as well as tackling ideological issues in the digital sector's development, in light of insufficient skills and a strong willingness from Party officials to act within the digital sphere.

As argued in this paper, the concept of economic security, as part of the larger national security concept, draws a lot of attention within current CCP's ideological and political debates. Indeed, **the concept has an im-**

portant theoretical dimension, but in practice its implementation is gradually and slowly progressing – especially with regards to social stability. Currently, the implementation of its economic security is therefore **more visible in terms of instruments to limit external contacts, restrict elemental exports and foreign exchanges**, or, in some cases, as part of a deliberate policy to strengthen sectors with a competitive advantage abroad. The “*security*” focus of the CCP remains the construction of a “*security state*” to preserve the regime's power, with vague economic aspects being important but subordinate to hard security policies.



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Supply Chain Resilience: China's Search for Vertical Integration

China must “*promote the advanced industrial foundation and modernization of the industrial chain*” (推进产业基础高级化，产业链现代化) and “*comprehensively improve the advanced industrial foundation and the modernization level of the industrial chain*” (全面提升产业基础高级化和产业链现代化水平). These were the words used by Xi Jinping in Guangdong and Jiangsu during inspections in April and July 2023.¹ **There has been much discussion about economic security in G7 countries, but economic security in China still receives less attention.** However, official and scholarly documents demonstrate that the topic is no less important to the Chinese Communist Party (CCP), at least from the angle of the resilience of supply chains, mentioned on several occasions as a fundamental component of “*how to guarantee China’s economic security*”.

The report of the 20th National Congress of the CCP discusses economic security at point 1, as a fundamen-

tal component to achieve the security of the Chinese people. It is presented in the famous construct of “*political security as the bedrock (根本), economic security as the foundation (基础), military, scientific, technological, cultural and social security as the assurance (保障)*”.²

More recently, at the National Development and Reform Commission (NDRC) meeting in July it was stressed how the Central Committee and the State Council made plans for the economic work for the second semester that included the consolidation of “*the foundation of economic security*” and the strengthening of a “*stable production and supply of grain and important agricultural products, [...] the capacity building of energy and resource security*”, the promotion of “*an industrial supply chain to supplement, extend, upgrade, and build supply chains*” and the effective maintenance of data security.³

¹ Cao Jianhai, “Why emphasize the advance of the industrial chain modernization (为什么强调推进产业链现代化)”, *Economic Daily*, July 26, 2023, http://paper.ce.cn/pc/content/202307/26/content_278056.html

² “Hold high the great banner of socialism with Chinese characteristics and strive in unity to build a modern socialist country in all respects – Report at the Twentieth National Congress of the Communist Party of China (高举中国特色社会主义伟大旗帜 为全面建设社会主义现代化国家而团结奋斗 — 在中国共产党第二十次全国代表大会上的报告)”, *The People’s Republic of China*, October 25, 2022, https://www.gov.cn/xinwen/2022-10/25/content_5721685.htm

³ “The National Development and Reform Commission held a briefing on the first semester’s development and reform situation (国家发展改革委召开上半年发展改革形势通报会)”, *National Development and Reform Commission*, July 30, 2023, https://www.ndrc.gov.cn/fzggw/wld/zsj/zyhd/202307/t20230730_1358957.html

Li Daokui, Dean of the Institute for Chinese Economic Practice and Thinking at Tsinghua University, identifies five major areas as pivotal for the future of the economy, the fourth one being economic security – preceded by energy, digital transformation and industries that make up for current shortcomings and followed by technological innovation.⁴ While elaborating on the importance of ensuring economic security, Li highlights the case of raw materials. **China is notably well placed in mining and processing of raw materials, but less so in reserves of certain materials.**

Thus, supply chain resilience is also part of the technology security agenda. Technology security is at times mentioned as being part of the economic security agenda and at times mentioned separately. Regardless of how they are mentioned, **economic security and technology security are deeply intertwined in the debates regarding supply chain resilience.** For example, raw materials stand at the basis of numerous supply chains that matter both for economic security and technology security.

Economic security, self-sufficiency, and vertical integration

Economic security is reaffirmed as a cornerstone of China's national security, and supply chain resilience as a core element of the country's economic security. Although different approaches to supply chain resilience have been formulated, **the Party, scholars and businesses appear to converge on two elements: self-sufficiency (as much as possible) and vertical integration.** The two are interlinked as vertical integration is first and foremost a domestic task, which seeks to reduce reliance on international supply chains for the Chinese system. Integration starts

from government funds – when possible – and ideally covers the whole down-, mid- and upstream supply chain. The process can develop in two directions. Top-down, the first, if the government funds projects to increase self-sufficiency and vertical integration of a supply chain such as the building of storage units for supplies and as proposed by Li Daokui. Top-down processes often have a special role carved out for SOEs. The other direction is bottom-up, as is the case with the Chinese electric vehicle (EV) producer BYD, where a company aligns with the Party direction and builds its own vertical integration leveraging the advantages of the Chinese home system.

Neither the Party nor the businesses – at least not all – appear satisfied with obtaining a strong position in only one element and/or stage of the supply chain.

Both the case of BYD and the assessment of China's position on the pharmaceutical supply chain that will follow suggest that **neither the Party nor the businesses – at least not all – appear satisfied with obtaining a strong position in only one element and/or stage of the supply chain.** Rather they assess the lack of a strong position in the supply of any component or at any stage of the supply chain as a weakness that needs to be tackled. That is notably the case for China's (relative) strong position in the supply chain of raw materials such as nickel and lithium, where China is strong in the processing stage of the supply chain but less so in terms of reserves or mining. This state of affairs is considered a vulnerability that needs to be addressed.

⁴ Li Daokui, "In the next 5-10 years, the 'fight for the economy' will be driven by five major industries (未来5—10年'拼经济'靠五大产业拉动)", *Cnstock*, March 19, 2023, <https://news.cnstock.com/news/bwxx-202303-5033144.htm>

Li Daokui precisely highlights the problem of China's low nickel production. Nickel is important for the production of stainless steel and lithium batteries. China has about 3% of global reserves of nickel and currently 4% of global share of nickel mining. However, China's real strength is in processing, where it holds a 68% global share. China faces a similar issue with lithium: 6% of global reserves, 14% of global share of mining and as much as 59% of global processing.

Li proposes that China should deal with low production not exclusively by reshoring production but also by building storage for supplies needed for six months to one year. The construction of such facilities would require large funding, and should thus be supported by the government and see the cooperation of state-owned enterprises (SOEs).

China should deal with low production not exclusively by reshoring production but also by building storage for supplies.

Integration and coordination among national players in what Li describes as the “national team” (国家队) is the baseline approach for China's economic security and supply chain resilience. This is an approach that China and Chinese entities have long

adopted in a system of domestic vertical integration that has brought great advantages to its SOEs' growth and competitiveness internationally.

From raw materials to final products, China has been planning and implementing measures to ensure resilience of the country's supply chains.

Applying vertical integration to the electric vehicles sector

Plenty has been written about Chinese companies' growing presence in the EV sector.⁵ In 2020, the State Council adopted the New Electric Vehicle Industry Development Plan (2021-2035), which aimed at boosting the competitiveness and global market shares of Chinese EVs.⁶ The plan was embedded in the dual-circulation economy model, which sought to leverage China's domestic market to then expand globally. Indeed BYD's main market was China for the past two decades. BYD then expanded its footprint to developing economies with a model based on business partnerships with car rental, taxi and ride-sharing companies.⁷

One of the elements that contributed to BYD's success was the construction of its own supply chain for the production of key components. BYD already produced core technological components such as batteries, motor electronic controls and chips that allowed it to increase its production. BYD's vertical inte-

⁵ Ilaria Mazzocco and Gregor Sebastian, “Electric shock: interpreting China's electric vehicle export boom”, MERICS, September 15, 2023, <https://www.merics.org/en/report/electric-shock-interpreting-chinas-electric-vehicle-export-boom>; François Godement, “L'antidumping et les véhicules électriques chinois : une ligne Maginot européenne (Antidumping and Chinese electric vehicles: a European Maginot Line)”, Institut Montaigne, September 14, 2023, <https://www.institutmontaigne.org/expressions/lantidumping-et-les-vehicules-electriques-chinois-une-ligne-maginot-europeenne>

⁶ “Notice of the General Office of the State Council on the New Energy Automobile Industry Development Plan (2021-2035) (国务院办公厅关于印发新能源汽车产业发展规划(2021—2035年)的通知)”, State Council, November 11, 2020, https://www.gov.cn/zhengce/content/2020-11/02/content_5556716.htm

⁷ See MERICS' China Global Competition Tracker October 2023

gration allowed it to reach a degree of self-sufficiency in upstream and downstream supply chains that exceeds 50%.

Now that **BYD has been able to establish itself more solidly in the home market and increasingly in developing economies, it is adopting a new approach by partially moving away from the closed vertical integration model** and opening its supply chain model to more suppliers in order to improve efficiency and further expand the business.⁸ For example, BYD is now negotiating the purchase of lithium mines in Africa.

The pharmaceutical sector, a resiliency still in the making

The supply chain of medicines and pharmaceutical goods has become ever more important following the disruptions experienced during the pandemic of Covid-19. **Despite what is often reported, the resilience of China's pharmaceutical sector is relatively low and so is its resistance to potential external shocks.** True, China's position as a supplier of active pharmaceutical ingredients (APIs) is favorable (approximately 40% of global share) and the country's registration of new patents is also growing – in 2021, it accounted for 20% of new applications.⁹ However, a paper from Guo Chaoxian and Xu Tingting, from the Institute of Industrial Economics of the Chinese Academy of Social Sciences (CASS) and the School of

Applied Economics of the University of CASS, shows that one of the main perceived risks to the resilience of China's pharmaceutical sector is that of disruptions of international supply chains due to “*decoupling*” and what the authors refer to as a “*promotion of de-sinicization*” of supply chains.¹⁰

Despite what is often reported, the resilience of China's pharmaceutical sector is relatively low and so is its resistance to potential external shocks.

The solution proposed by the authors is to boost domestic innovation capacities in order to diminish reliance on foreign countries for core technologies, a theme promoted during the 20th National Congress. Another solution pushed forward once again, stresses the importance of vertical “*in-depth integration of production, education and research, promoting the deep integration of innovation chain, industrial chain, capital chain and talent chain*” (产学研深度融合, 推动创新链, 产业链, 资金链, 人才链深度融合, 夯实本土产业链供应链根植性).

⁸ Li Xiaoxiao, “Research on the operation model of new energy vehicle supply chain under the dual-circulation development pattern—Taking BYD brand as an example (双循环发展格局下新能源汽车供应链运作模式研究——以比亚迪品牌为例)”, *Economic Information Daily*, February 6, 2023, <https://m.fx361.com/news/2023/0206/17737552.html>

⁹ “The great medicines migration – How China took control of key global pharmaceutical supplies (Part 3)”, *Nikkei Asia*, April 5, 2022, <https://asia.nikkei.com/static/vdata/infographics/chinavaccine-3/>

¹⁰ Guo Chaoxian and Xu Tingting, “Research on supply chain resilience and the security level of China's pharmaceutical industry (我国医药产业链供应链韧性和安全水平研究)”, *Economy and Management*, No.3 (2023), https://chn.oversea.cnki.net/KCMS/detail/detail.aspx?dbcode=CJFD&dbname=CJFDLAST2023&filename=JJGL202303010&uniplatform=OVERSEA&v=XYax6IPkuUueNHW8sejJ5231I-oQj3VyJSrpWew5_DT8MRmYpjiPiSSpueWtmMxQ

Resilience at its extremes

Chinese entities are well ahead in the preparation and implementation of approaches to guarantee supply chain resilience for different sectors. **The vertical integration approach has brought about a number of initial successes for China**, allowing China's footprint in a number of supply chains to grow. However, that seems insufficient to ease a pervasive sense of precarity and insecurity. On the contrary, it appears that **China's achievements cannot simply**

be maintained, they have to be further expanded, up and downstream, as well as geographically. It is not just about dominating certain areas of supplies or certain chokepoints, it is about guaranteeing that there are no weaknesses, no exposures to risk for the Chinese supply chain. To a certain extent, thus, unlike the approach adopted by G7 countries that aims at risk management but still accepts a certain degree of risk, China's approach analyzed here resembles more a strategy aimed ultimately at maximizing risk-avoidance, at least in key industries.

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Europe's Turn to Economic Security: Does It Really Matter?

"Mitigating risks to its supply chains, critical infrastructures and technology security".¹ This is how Věra Jourová, Vice-President for Values and Transparency of the European Commission, described economic security to her counterpart Zhang Guoqing, Vice-Premier of China, during the recently-held EU-China Digital Dialogue. The EU Commission presented its Economic Security Strategy in June 2023,² and the EU anti-coercion instrument was adopted by the European Parliament in the first week of October.³ How did the

Chinese expert community receive the proposed strategy and what do they expect for the future of EU-China economic ties?

Sun Yanhong, Director and Researcher of the European Economic Research Office of the Chinese Academic of Social Sciences (CASS)'s European Institute, certainly gets recent developments in Brussels right when she argues that the Commission's EU economic security strategy June proposal was not a "sudden

¹"EU-China: Commission and China hold second High-level Digital Dialogue", European Commission, September 18, 2023, https://ec.europa.eu/commission/presscorner/detail/en/jp_23_4488

²"President von der Leyen presents the European economic security strategy and the revised multiannual EU budget", European Commission, June 20, 2023, https://ec.europa.eu/commission/presscorner/detail/en/AC_23_3401

³"Europe and economic coercion", Institut Montaigne, November 11, 2022, <https://www.institutmontaigne.org/en/series/europe-and-economic-coercion>

move".⁴ Rather, she sees it as the culmination of years of Europe's mainstream political economy shifting conservatively, resulting in a significant change in economic policy.

De-risking, decoupling or economic security?

A recurring comment is the need for the EU to clearly define the concept of economic security, but some Chinese scholars undeniably see this change as nearly paradigm-changing. Yan Shaohua, an Associate Researcher at Fudan University's Center for China-EU Relations, notes that this policy shift stems from the EU's growing dissatisfaction with the unequal benefits in the EU-China economic relationship. This has led to the EU move away from its traditional framework of trying to "promote change through business interactions" (以商促变).⁵ In addition, **while economic and security issues used to be separate in Europe, this is no longer the case.**

While economic and security issues used to be separate in Europe, this is no longer the case.

Of course, as pointed out in another of Yan's analyses, the EU moved the global policy conversation from "decoupling" to "de-risking", which he argues amounts to a "rational and pragmatic attitude" (理性务实的态度).⁶ Unlike decoupling, a de-risking strategy is much narrower in scope – he interprets it as reflecting the EU's intention to manage economic dependencies with China while maximizing benefits of the relationship.

Along the same lines, Wang Huiyao and Miao Lu, respectively Chairman and Secretary General of the Center for China Globalization, a public diplomacy entity very active in Europe, openly make the point that de-risking should not be understood as targeting China.⁷ Rather, they portray the term as **a strategic decision resulting from an assessment of Europe's economic and security environment, driven by a genuine need for diversification.** Song Wei, a Professor at Beijing Foreign Studies University's School of International Relations and Diplomacy, also emphasizes the disparities in transatlantic interpretations of "economic security".⁸ For her, whereas the US blurs the line between economic security and national security, the "EU prefers to view security through a more military lens" (欧盟更倾向于通过偏军事的视角来看待安全). In brief, her vision can be summed up as follows: a wide competitiveness approach in the US, versus a narrow national security one in Europe.

⁴ Sun Yanhong, "EU launches economic security strategy to promote 'risk removal' (欧盟出台经济安全战略推进“去风险”); Cfsinet, July 31st, 2023, <http://comment.cfsinet.com/2023/0731/1328358.html>

⁵ Yan Shaohua, "An analysis of the Russian factor in China-EU relations (中欧关系中的俄罗斯因素论析); Aisixiang, June 19, 2023, <https://www.aisixiang.com/data/143794.html>

⁶ Yan Shaohua, "Macron and Von der Leyen visit China: The temperature difference in China-EU relations (马克龙与冯德莱恩访华: 中欧关系小阳春中的温差); Fudan Development Institute, April 13, 2023, <https://fdi.fudan.edu.cn/73/c0/c21253a488384/page.htm>

⁷ Wang Huiyao and Miao Lu, "As dignitaries visit China one after another, what changes have occurred in European mentality? (政要纷纷访华, 欧洲心态有了哪些变化?); Center for China and Globalization, June 5, 2023, <http://www.ccg.org.cn/archives/76041>

⁸ Song Wei, "Allies are 'making other choices' one after another, and the United States is facing a dilemma (盟友纷纷“另作选择”, 美国面临窘境); Global Times, August 7, 2023, <https://opinion.huanqiu.com/article/4E1SV2S5QJx>

⁹ Zhong Feiteng, "How to understand the United States and the West's 'de-risking' approach to China (如何理解美西方对华“去风险”); World Affairs, July 5, 2023, <https://mp.weixin.qq.com/s/PO6qrQvWkWCuuwUOH-6Imw>

There is no consensus however, as **some Chinese analysts see a transatlantic alignment on de-risking**. Zhong Feiteng from CASS's Institute of Asia-Pacific and Global Strategy, is the closest to Chinese official talking points when he argues that "*de-risking from China*" is in substance very similar to decoupling.⁹ Wang Lei and Sun Ru, from the Institute of World Political Studies of the China Institutes of Contemporary International Relations (CICIR), arguably China's most influential think tank, consider American and European strategies to be very similar.¹⁰ Both approaches advocate for economic and industrial security, the diversification of supply chains, and the protection of basic technologies and sensitive high tech (AI, semiconductors, batteries).

Economic security is presenting "*challenges that cannot be ignored*" (不容忽视的挑战) for both sides.

Chen Xi, Researcher at the China-Europe International Business School, offers the most concrete assessment of the possible impact on EU-China relations. She sees **economic security as presenting "challenges that cannot be ignored" (不容忽视的挑战) for both sides**.¹¹ This shift occurs despite a record of positive EU-China economic and trade cooperation in the past two years, helping each side to overcome difficulties and demonstrating strong resilience: that is how Chen characterizes the new step initiated by the European

Commission. In terms of tangible impacts, Chen Xi highlights three main developments.

First, an anti-subsidies investigation into Chinese exports of electric vehicles would "*inhibit the positive development trend in EU-China economic and trade relations*" – the piece was written before the European Commission launched the investigation. Second, the German government significantly reduced its investment guarantees to support German companies' investment in China in recent years. According to her, the Federal Ministry of Economic Affairs approved 37 investment guarantees in 2013, but only 9 in 2022, and 5 in the first half of 2023. The German government also rejected investment guarantee applications worth a total of 4 billion euros. As Germany has been the largest supplier of European FDI to China, this trend will directly affect the scale of China's attraction of foreign capital.

Thirdly, Chinese companies seeking to invest in Europe are facing several challenges beyond the EU's FDI Screening Regulation. Chinese companies have to face in addition the EU's Foreign Subsidy Regulation and anti-monopoly rules. This triple-review process creates a complicated landscape for would-be Chinese investors. In 2022, Chinese FDI in Europe had decreased by 23% year-on-year (for a total value of 7,9 billion euros),¹² continuing a trend of sharp and continuous decline over a period of three years. Hereafter, this has to be attributed to the severe shrinkage of M&A transactions according to Chen.

¹⁰ Wang Lei and Sun Ru, "De-risking theory' reflects new strategic adjustments of Europe and the United States towards China (去风险论"折射欧美对华战略新调整)", May 24, 2023, China-US Focus, <http://cn.chinausfocus.com/foreign-policy/20230524/42858.html#>

¹¹ Chen Xi, "How should China respond to the escalation and evolution of the EU's economic strategy towards China? (中国当如何应对欧盟对华经济战略的升级和演变?)", CEIBS Lujiazui International Institute of Finance, July 5, 2023, <https://cliif.ceibs.edu/article/19900>

¹² Agatha Kratz, Max Zenglein, Gregor Sebastian, and Mark Witzke, "Chinese FDI in Europe: 2022 Update", Rhodium Group, May 9, 2023, <https://rhg.com/research/chinese-fdi-in-europe-2022-update/>

According to Sun Yanhong, the EU Commission's strategy was especially motivated by concerns about risks and competitiveness in sectors crucial to the digital and green transitions. Her view, however, overlooks the issues of unequal access, exploitation and technology theft in EU-China relations. As a result, the underlying logic of Europe's internal and external economic policies changed from "efficiency first" (效率至上) to "equal emphasis on efficiency and security" (效率与安全并重), and even "security first" (安全至上).¹³ She does acknowledge the extreme European dependence on Chinese suppliers for critical materials such as rare earth and magnesium, which reports of the European Commission highlighted in recent years¹⁴ – if the "voices of excessive dependence on China have become louder" (这使得其内部担忧“对华依赖”的声音更为甚嚣尘上), that is also as a result of objective facts. At the same time, she notes that less than 1% of Europe's total imports from China, according to European Commission reports, are in high-risk categories today – an observation that puts the "decoupling" narrative into perspective.

Facing an international coalition of de-risking powers

Experts from the EU Studies Center of Shanghai International Studies University and the European Society of Shanghai mainly see the shadow of the United States behind the EU's economic security steps, a

shadow that had already been cast on Japan.¹⁵ They see this as the US "stepping up its efforts to win over Europe", leading to a "new round of deep adjustment in how European elites perceive China's strategy and decision-making intentions".

Jian Junbo, Deputy Director of Fudan University's Center for China-Europe Relations, argues that Europe now perceives China as a threat – but he sees this as part of a bloc confrontation perspective, with de-risking creating a needed "glue" (粘合剂) that holds together a common transatlantic China agenda.¹⁶ What could play to the EU's advantage is the possibility to "use an ambiguous vocabulary and unspoken meaning to provide enough space for [it] to implement a more flexible economic and trade policy toward China" (用一种模糊的词汇和不言明的含义为欧洲实施更灵活的对华经贸政策提供足够的空间) – an analysis like a mirror image of the Chinese playbook of creating grey areas to maximize space for executive action.

Many Chinese observers share this perspective while emphasizing variations in the extent to which Europe and the United States adopt defensive economic policies vis-à-vis China. The Shanghai group of European experts concludes that the EU's approach is not as "radical and confrontational" as the US one. They see indications that Europe still prioritizes "openness, integration and dialogue".

¹³ Sun Yanhong, "EU launches economic security strategy to promote 'risk removal' (欧盟出台经济安全战略推进“去风险”)", Cfsnet, July 31st, 2023, <http://comment.cfsnet.com/2023/0731/1328358.html>

¹⁴ European Commission, "Updated in-depth review of Europe's strategic dependencies", February 23, 2023, https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1124; European Commission, "Commission staff working document, strategic dependencies and capacities", 5 May 2021, https://commission.europa.eu/system/files/2021-05/swd-strategic-dependencies-capacities_en.pdf

¹⁵ Hou Danwei and Nan Boyi, "The European Commission issues an Economic Security strategy, EU summit winds up strategic adjustments" (欧委会发布《经济安全战略》: 欧盟峰会对华战略调整风向标?), The Paper, June 28, 2023, https://m.thepaper.cn/newsDetail_forward_23640038

¹⁶ Jian Junbo, "Europe proposes to 'de-risk' from China: how many risks are behind this vague word? (欧洲提出对华“去风险”: 模糊话语背后有多少风险?)", The Paper, June 27, 2023, https://www.thepaper.cn/newsDetail_forward_23617214

The (national) weak spots of the European strategy

France and Germany's positions are identified as two weak spots in the EU's adoption of an economic security agenda. In 2022, He Zhigao, an Associate Researcher at the Institute of European Studies of the Chinese Academy of Social Sciences (CASS), had however portrayed France and Germany as prioritizing economic security when reshaping Europe's attitude towards China.¹⁷ Since, the dynamic between the Commission and Member States has shifted. Chen Xi argues that Germany can be used as a "breach" (突破口) to "reinforce lobbying" in favor of Chinese positions in the area of electric vehicles subsidies, in order to "cultivate a positive public opinion environment" for China in Europe.¹⁸

On strategic issues, France might also be a weak spot. For Zang Shumei, a Research Fellow at the East China Normal University in Shanghai, France is a fierce advocate of European strategic autonomy, which she characterizes as a point of contention in the transatlantic relationship. But at the same time, **France's "maverick role" (特立独行) is limited in scope, as can be seen from the lack of negative impact of such French positions on the transatlantic alliance.**¹⁹

France's "maverick role" (特立独行) is limited in scope, as can be seen from the lack of negative impact of French positions on the transatlantic alliance.

The "complexities and ambiguities" in the distribution of power and competences in the EU system provides opportunities for China to seek to **neutralize the European strategy.** From a national standpoint, Sun Yanhong reminds her readers that some Member States have not yet implemented a national FDI screening system, as doing so is an exclusive sovereign competency. She anticipates similar challenges if the EU were to adopt an outbound FDI screening regulation.

How can China respond to this trend? Chinese experts suggest several approaches. First, **Chinese entities should fully grasp the regulations' meaning, adhere to them to handle compliance risks, while also actively seeking for potential weak spots.** For instance, Chen Xi points out that the EU's anti-subsidy regulation's prior declaration rules only take effect on October 12, 2023. This deadline creates a short time frame, given that reporting requirements will result in transaction costs and new risks.

Her second advice is to focus on greenfield investment since M&A activities have become less feasible. In 2022, for the first time since 2008, the volume of greenfield projects in Chinese investments in Europe surpassed that of M&A transactions, accounting for 57% of the total. Europe needs Chinese companies for its green transformation but there is no particular securitization of greenfield investment in the EU. This is where a space for business expansion exists for Chinese players.

¹⁷ He Zhigao, "If Macron is re-elected, what kind of Europe will we usher in? (马克龙连任，我们将迎来一个怎样的欧洲?)", Institute of European Studies of the Chinese Academy of Social Sciences, April 27, 2023, http://ies.cssn.cn/cn/work/comment/202204/t20220428_5406252.shtml

¹⁸ Chen Xi, "How should China respond to the escalation and evolution of the EU's economic strategy towards China? (中国当如何应对欧盟对华经济战略的升级和演变?)", CEIBS Lujiazui International Institute of Finance, July 5, 2023, <https://cliif.ceibs.edu/article/19900>

¹⁹ "The European Commission releases the 'Economic Security Strategy': is the EU Summit a vane for strategic adjustment towards China? (欧委会发布《经济安全战略》：欧盟峰会对华战略调整风向标?)", The Paper, June 28, 2023, https://m.thepaper.cn/newsDetail_forward_23640038

Finally, Ding Chun, Director of the Center for European Studies at Fudan University, already argued in 2021 for a Chinese focus on diversification away from Europe and the US, a doubling down on the Belt and Road Initiative, an active engagement in restructuring of regional value chains in Asia, and an increased investment in its national innovation capacity.²⁰

The EU's economic security strategy is therefore undeniably perceived as a challenge, partly due to the need for clearer terminology, but the bloc's vulnerabilities also create opportunities for Chinese adaptation.

²⁰ Ding Chun, "The EU's quest for resilient supply chains is not 'decoupling' (欧盟寻求弹性供应链并非“脱钩”); Belt and Road Initiative & Global Governance Institute, May 12, 2021, https://brgg.fudan.edu.cn/articleinfo_3467.html

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