

# Bolstering Economic Security



“Building resilience will mean increasing our production of certain types of elements here at home. In others, it’ll mean working more closely with our trusted friends and partners, nations that share our values, so that our supply chains can’t be used against us as leverage.”<sup>21</sup>

Joe Biden, US President, signing of an executive order on supply chains, February 24, 2021

## The Stakes

China has a long track record of industrial and technology policies that involve a highly strategic management of its global interdependencies and commercial relations. Beijing’s efforts are underpinned by government programs aimed at achieving dominance in key market segments and value chains. To this end, China pursues an intensive and systematic campaign of exploiting technology transfers from imports and joint ventures, acquisition, and espionage to leapfrog industrial development, modernize its military, and improve China’s relative global power position.<sup>17</sup> China’s policies have moved beyond playing catch-up in various areas and constitute the world’s most ambitious experiment in “techno-nationalism” – with far-reaching implications for the competitiveness, security, and resilience of transatlantic partners.

As the free market economies that have gathered under the OECD’s umbrella are heavily invested in China and their global supply chains are deeply entangled with the Chinese market, they also share a set of economic security concerns vis-à-vis China. While such concerns traditionally relate mostly to “technology leakage” narrowly defined, they are now expanding and include (1) preventing specific technology transfers with military and dual-use purposes as well as controlling access to cutting-edge and sensitive technologies, (2) strengthening resilience by managing vulnerabilities in supply chains, systems, and networks, and (3) preserving a healthy industrial base and long-term innovation capacity through targeted government funding of R&D and the protection of intellectual property. As the scope of concerns has expanded, so has the set of critical technologies that are of strategic importance.<sup>18</sup>

At the same time, the countervailing commercial incentives to deepen rather than limit interdependence with China are much higher than with any past competitor or adversary of the “West.” The vast Chinese market not only offers revenues that enable companies to spend more on R&D, but also makes it possible in certain sectors to innovate faster and make use of economies of scale.<sup>19</sup> Sustained unequal openness between the Chinese and the OECD markets, however, creates distortions that have a negative impact not only on future competitiveness but also the long-term resilience and economic security of Europe and North America. The security impli

cations deriving from growing interdependence with China are increased further by China's current political trajectory, its declared aim of becoming a leading technology player that is able to use (and abuse) its role in global supply chains for political goals, the growing innovation capacity and global technological clout of Chinese companies, as well as Beijing's renewed focus on military-civil fusion and self-reliance policies.<sup>20</sup>



“We will seek cooperation with likeminded partners wherever we can to support open, fair and rules-based trade; reduce strategic dependencies; and develop future standards and regulations: all of which are critical for our economic strength.”<sup>22</sup>

Valdis Dombrovskis, European Commission Executive Vice-President for An Economy that Works for People, Update to the 2020 EU Industrial Strategy, May 5, 2021

### The State of Play

Recent transatlantic efforts to manage tech competition with China have already led to some initial coordination and/or alignment, including with a view to investment screening mechanisms and revamped export controls. However, the transatlantic community will need to step up its game, as China is increasingly capable and willing to leverage or weaponize economic dependencies, including through the threat and use of retaliatory sanctions,<sup>23</sup> which is undermining the security of free market economies in more profound ways than in the past. Efforts to tackle economic security concerns in relations with China are also already intertwined with the emergence of a broader systemic competition, including over values (also embedded in the use and management of technologies), physical and digital infrastructures, and global diplomatic and geostrategic influence.

However, more effective transatlantic coordination is conditioned by prevailing differences in relative sensitivities related to economic security challenges as well as the competitive nature of technology development between like-minded partners. To overcome their differences, the transatlantic policy and business communities will be well served to follow a few key principles in their approach to economic security. First, allied coordination requires investments in mutual education, information exchanges and private sector dialogue on China and the challenges to economic security it poses. To this end, the recently launched EU-US Trade and Technology Council (TTC) and the envisaged establishment of technology coordination offices in G7 executive agencies that deal with economic security constitute important steps forward. Second, to reconcile global business activity and national security, and control certain technologies effectively, building higher walls for a limited scope of technologies while allowing other transnational business activities to be conducted with as few boundaries as possible should remain the preferred approach. Finally, for an efficient management of technology controls, targeted coordination efforts among flexible technology-specific groupings of countries seems the most promising approach.

### The Priorities

Allies need to “run faster” than China in innovation, technology development, and related standard-setting. This will require more joined-up R&D and industrial strategies and leveraging the existing competitive nature of US and European industries on global markets in limited strategic sectors. In the end, any joint action will only succeed with transatlantic leaders creating a narrative that will convince businesses and the respective publics within the US, Canada and Europe to sacrifice short-term economic gains for long-term economic security and reduced dependence on China. To jointly succeed in the bolstering of economic security over the next six to 18 months, transatlantic partners can and should pursue measures in a number of priority areas:

#### Closing gaps in and future-proofing technology control toolboxes

Transatlantic partners should invest in the multilateral architecture by strengthening the Wassenaar Arrangement, which could include additional resources as well as more frequent updates that capture more adequately the rapid pace of technology development. They should also establish permanent dialogue structures across the Atlantic – and parallel to the relevant multilateral frameworks, to (more rapidly) harmonize the definition and scope of critical emerging and foundational technology definitions.

Another aim should be to establish a regular exchange and information sharing mechanism among transatlantic partners and Japanese and South Korean legislatures on China and economic security in form of joint committee meetings or joint (public) hearings. Greater coordination in this grouping could also include supporting industry associations in Japan, South Korea, the US, Canada, the EU and other European countries to establish best practices for export control compliance and internal company governance.

Transatlantic partners should expand the scope and coordination of screening mechanisms for key technologies, such as quantum or AI, to capture venture capital investments and R&D collaboration with Chinese entities.

The US, Canada, and Europe should invest in more coordinated responses to Chinese cyber theft and attacks, including by establishing liaison officers, conducting joint training and exercises, cyber security policy simulations, and improving modalities for threat and vulnerability intelligence sharing.

### Improving supply chain and technology security through diversification

Transatlantic partners should coordinate information-sharing on (ongoing) supply chain risk reviews, which could include a particular focus on methodology, findings, and the intersections between vulnerabilities.

They should invest in mechanisms that support the establishment of common principles for managing risks associated with non-trusted suppliers for technologies, including on 5G and in the future 6G, building on the EU’s “5G toolbox” and the Prague principles precedent.

Transatlantic partners should work with like-minded economies, such as Japan, on building a large, trusted space of free flows of data to build scale, with Taiwan and South Korea on semiconductor development, with Australia on rare earth supplies, with India on pharmaceuticals, and with key emerging economies on digital connectivity to diversify relations and limit risk accumulation.

### Mitigating the risks of Chinese economic coercion

Transatlantic partners should jointly invest in research and risk assessments toward transparency around critical Chinese activities that create or enhance the potential for economic coercion around technology choke points. The G7 or the TTC should mandate research for and the publication of an annual flagship resilience and economic security report that articulates the research and risks.

They should move to establish a collective security mechanism against economic and political coercion with like-minded countries. Such a mechanism should be triggered when a country is targeted by Beijing. A more ambitious version of this would involve automatic responses to Chinese coercion that would kick in as agreed upon by parliaments in advance. A first step would be to work with countries that have already been targeted by Beijing’s coercive efforts.

Transatlantic partners should invest in risk assessments and potential joint responses to threats of future “infrastructure capture” or dominance by China, including by assessing the scope for coordinating digital currency developments.