In our first article, we reviewed the nature of the contemporary UK–China commercial relationship and its potential for growth. We also observed that business with China is ‘just business’, until, suddenly, it is not. ‘Business as usual’ becomes ‘business unusual’. This second article considers how non-economic factors influence the commercial relationship, and explores whether this creates dependence or interdependence and how the UK is responding.

A History of Engagement

Since the start of reform and opening up in 1978, foreign trade and investment has played an important role in China’s economic development: there was close alignment between China’s national strategic objectives and the deals negotiated by local governments and state-owned companies. In turn, foreign companies profited from China’s low manufacturing costs, investment incentives and growing consumer markets. Both sides gained.

Western commercial efforts took place in the context of a policy of engagement, that saw trade and economic interdependence as a way to encourage further reform in China and create a middle class that would demand political liberalisation and even democracy. The clearer separation of business and government in the West meant, however, that this link with national policy was looser than in China. The main Western beneficiaries were companies building their China businesses and consumers enjoying low-priced imports.

In the current geopolitical environment, it is increasingly hard to separate commercial relationships cleanly from other aspects of policy

China has now emerged as the world’s largest exporter and second-largest economy. Economic growth has not, however, led to political liberalisation. Since Hu Jintao, the Chinese leadership has taken a more assertive and unapologetic approach to China’s interests. Xi Jinping has reasserted the leading role of the Chinese Communist Party (CCP) and tightened control of internal debate and foreign influence. This has changed the context for commercial relations.

Three Considerations for China’s External Commercial Relations

Julian Gewirtz argues that the Chinese leadership considers external commercial relations from three aspects. First, trade and investment continues to be an engine of economic growth and technological development for China, consistent with continued opportunities for foreign companies. Second, reliance on foreign trade and investment is a source of risk due to China’s dependency on other countries. Recent US actions restricting semiconductor sales to Huawei have made this very tangible. Third, trade and investment in turn gives China a source of leverage over other countries due to their dependency on commercial relations with China.

Under Xi, these latter two considerations have become more prominent. According to Gewirtz, Xi ‘endorses an expansive concept of “big security” (大安全) that explicitly encompasses the security of important industries and key areas that are related to the lifeline of the national economy’. Xi has talked of ensuring ‘development security’, which means making the economy less vulnerable to external shocks. This continues a policy of bolstering the capabilities of Chinese companies and reducing reliance on foreign companies, both raising living standards and reducing external risk. Total trade (exports plus imports) fell from 64% of Chinese GDP in 2006 to 32% in 2019.

A Shift in the UK Debate

Since the 2015 ‘Golden Era’ launched by then Prime Minister David Cameron and President Xi, UK trade with China has grown strongly, while companies continue to navigate familiar challenges of market access, political risk, contract
enforcement and intellectual property protection. However, more recently, the debate has shifted: are commercial relationships really ‘win–win’, or does that mean, in a now-hackneyed phrase, that ‘China wins twice’? Are the decisions made by individual companies in the overall best interests of the UK? The debate covers three main areas:

- **The political risk of dependency:** That the UK becomes dependent on China for key imports or critical national infrastructure (CNI), and so is constrained in its foreign policy by the need to keep China happy. Has dependence replaced interdependence?

- **Technology and security risks:** That the UK sells or allows access to technologies and know-how (broadly defined) that undermines the UK’s national interest and disproportionately benefits China; and that purchasing technology from China opens up the UK to security risks. Do we fully understand the deals that are being done?

- **Risks to British values:** That commercial relations with China either pose a threat to the UK’s values in some way or that trade in itself compromises these values in light of certain Chinese government actions. What role should values play in our commercial relations?

**The Political Risk of Dependency**

Two factors underpin concerns that the commercial relationship with China is one of dependency rather than mutual interdependence: China’s sheer scale as the world’s largest manufacturing exporter and provider of CNI; and China’s increasing willingness to use or threaten to use, both publicly and privately, its commercial relations for economic leverage.

**China as a major supplier of the UK’s manufacturing imports and infrastructure**

China is the world’s largest manufacturing exporter and is now the UK’s second-largest source of imports. One recent report identified products such as certain disinfectants, medical ingredients and electronics where the UK imports most of its domestic requirements from China. This represents a risk if supplies from China are all disrupted at the same time and alternatives are not easily available. For example, the Fukushima earthquake disrupted supply chains across Asia when Japanese factories shut down.

China has also become an important supplier of CNI in the UK. The Centre for the Protection of National Infrastructure describes CNI as ‘facilities, systems, sites, information, people, networks and processes, necessary for a country to function and upon which daily life depends’ and includes 13 sectors: chemicals, civil nuclear, communications, defence, emergency services, energy, finance, food, government, health, space, transport and water.

Key CNI projects with Chinese investment include Huawei’s role in 4G networks and 5G development, China General Nuclear Corporation’s 33.5% stake in the Hinkley Point C nuclear power plant and future plants in Sizewell...
and Bradwell, and possible Chinese involvement in the HS2 line. Whatever the supplier’s nationality, there are inherent project risks due to the long timescales involved and the locked-in supplier–customer relationship once the contract is signed.

China’s willingness to use commercial relations for economic leverage

These risks are inherent to commercial relationships, and businesses and governments are used to managing them. What makes the China discussion different is the concern that the Chinese government may use these relationships in a political way, beyond the specifics of individual deals. For example, during the coronavirus pandemic, it became clear that China provides most of the UK’s (and the world’s) personal protective equipment and could potentially restrict this supply. In fact, China rapidly increased exports of medical equipment throughout the pandemic. Nonetheless, just as China sees its reliance on US semiconductors as a risk, so its dominance in certain import categories and role in CNI represents ipso facto a potential vulnerability for the UK.

The pronouncements and actions of the Chinese government have contributed to, rather than allayed, such concerns. China has increasingly intervened or threatened to intervene in specific commercial relationships in recent years. Measures include direct regulatory actions and statements that Chinese consumers may express their displeasure through boycotts. Evan Feigenbaum has described a toolkit of differing methods of applying economic leverage. Countries affected include Canada over the extradition case of Huawei’s Meng Wanzhou; Germany and Denmark in retaliation for potentially excluding Huawei from 5G networks; and Indonesia in retaliation for a potential China travel ban to contain the spread of coronavirus.

China has also acted against foreign imports, with varying impact. Following the 2010 Nobel Peace Prize award to Chinese dissident Liu Xiaobo, China imposed an import ban on Norwegian salmon. This had little impact as the salmon was diverted via Hong Kong. Despite an angry Chinese response when David Cameron met the Dalai Lama in 2012, UK exports to China grew by 24% in 2013 and Chinese investment in the UK reached a new record. More recently, when Australia called for an inquiry into the origin of coronavirus, China suspended beef imports from four Australian abattoirs after veiled threats that Chinese consumers might no longer wish to ‘buy Australian’. However, it did not act on its imports of iron ore from Australia, that are strategically more important to China.

The Chinese operations of foreign multinationals have also been targeted. Actions include the encouragement of consumer boycotts and heightened audit and compliance inspections. Lotte’s China operations faced consumer boycotts and government inspections in response to the 2017 US deployment of the thermal high-altitude area defence missile system on Lotte-owned land in South Korea. Following record losses, Lotte has largely exited China, although it restarted a $2.6 billion real estate project there in May 2019. China also halted tour groups to South Korea, leading to a 48% fall in China–South Korea tourism in 2017, although tourism has resumed.

In June, Liu Xiaoming, China’s ambassador to the UK, called the Huawei 5G decision ‘a litmus test of whether Britain is a true and faithful partner of China’. In July, Global Times stated that ‘Beijing may have no other choice but to strike at British companies like HSBC and Jaguar’, in the context of the UK’s ‘hostile attitude’ and its suspension of the extradition treaty with Hong Kong. However, following the revised decision to exclude Huawei from UK 5G networks, Chinese media responses have been generally muted.

In summary, China often threatens – and does take – action. However, the impact in practice is highly variable, typically calibrated to not affect products of high value to China, and time limited. It can nonetheless do great harm to individual businesses.

Technology and Security Risks

There are also increasing concerns related to technology. This relates both to the sale of British technology to China and the use of Chinese technology in the UK.

Much of this is not new. Individual companies negotiate technology deals and will do so in their own best interests. Exports of military weapons and certain advanced ‘dual-use’ technologies with both civilian and military applications have always been subject to export control.

The UK would benefit from asserting its own distinctiveness and appeal to China with more confidence

Two changes have increased the need for a stronger UK policy focus. First, the growing digitisation and increasingly pervasive use of information technology means that technologies are increasingly ‘dual-use’, with inherent national security and commercial aspects. In the case of China, Xi’s ‘military–civil fusion’ strategy reinforces this. Second, Xi has prioritised the strengthening of China’s domestic technology capabilities, especially in the ‘Made in China 2025’ strategy. China will soon launch a China Standards 2035 industrial plan, with the ambition to boost its innovation and advanced industrial capacity, and to set standards that define production, exchange and consumption with global reach. This is both a natural path for China’s continued economic development and reduces reliance on other countries.

In this context, China remains interested in acquiring UK technology and biotech companies in order to gain control of leading technologies. For
example, the bid by China Reform Holdings, a state-owned investment company, for UK chip designer Imagination Technologies Group at the peak of the coronavirus crisis, sparked concern that Imagination’s technology assets could be shifted to China.

The issue goes beyond agreed commercial deals. The UK, US and Australia are evaluating how the Chinese government may be using international academic programmes to access strategic sector research and technology. A 2018 study by the Australian Strategic Policy Institute showed that roughly 500 Chinese military scientists have studied in the UK since 2007. This includes a Chinese military scientist who in 2016 completed a PhD from Manchester University in graphene technology, which has military applications. There is also evidence of China launching cyber attacks on UK companies to gain knowledge, for example, on a COVID-19 vaccine.

China has also been keen to secure the UK as a flagship customer for its 5G, nuclear and high-speed rail technologies. In the case of Huawei, this has prompted concerns that using a Chinese supplier could both increase access to vital data and communications for espionage and surveillance, as well as give China the capability to disrupt critical networks. Many of these risks are inherent in technology today and exist regardless of supplier nationality, but the impact of supplier nationality does nonetheless need to be assessed and managed through a cyber risk management approach. More recently, the data collection practices of TikTok, owned by China’s Bytedance, have come under scrutiny. But the BBC reported that ‘much of TikTok’s data collection is comparable to other data-hungry social networks such as Facebook’.

Governments everywhere are struggling to develop the appropriate regulatory framework for new technologies. The rapid pace of innovation and the dual, pervasive role of technology in economic growth and national security makes this challenging. All the more so in the case of China.

Risks to British values

Rather than the liberalisation hoped for by Western leaders over the past decades, the CCP has taken a tighter control of public debate, education, media and religious beliefs in China. Issued in 2013, China’s Document No. 9 warned of the dangers of Western values such as constitutional democracy and universal definitions of human rights. The clash with Western values has become much sharper. With the introduction of the National Security Law, this controlled environment is increasingly spreading to Hong Kong. Globally, China has become more vocal in seeking ‘discourse power’, wanting to project its perspectives commensurate with being the world’s most populous country.

For UK companies, doing business in China means accepting these conditions or deciding to leave. British schools in China must teach the Party-approved curriculum and not cover topics such as the 1989 Tiananmen Square events.

The issue becomes more challenging still when Chinese individuals come to the UK for education: British universities have seen a 35% increase in Chinese students over the last five years, so that China has become an important source of revenue. There are some fears that this could constrain academic freedom, with academics potentially self-censoring research to preserve relations with China. All students must be able to contribute freely without fear of reprisals.

How the UK is Responding

In the current geopolitical environment, it is increasingly hard to separate commercial relationships cleanly from other aspects of policy. The UK government is increasingly conscious of this as regards China. Despite initial ambitions to move quickly to a post-Brexit free trade agreement with China, a reassessment is underway. The creation of the China Research Group in the House of Commons has provided additional impetus. Both the Huawei decision and the clampdown in Hong Kong have cooled UK–China relations. But Chinese Embassy statements have underscored that this need not imperil the bilateral relationship, with particular attention to the value of the economic relationship.

Following the outbreak of the coronavirus pandemic, Prime Minister Boris Johnson has reportedly ordered the government to draw up strategies to reduce the UK’s reliance on Chinese imports under the codename ‘Project Defend’. The UK has also started re-examining its investment screening process in 2018. Johnson, facing growing pressure in Westminster, may fast-track new legislation to tighten inward investment through a National Security Investment Bill. A new approach would involve greater government oversight on technology acquisition and place more emphasis on reciprocal access for UK companies to China’s market.

China has increasingly intervened or threatened to intervene in specific commercial relationships

The UK can also help encourage additional supplier options. Japan’s Hitachi has expressed interest in UK nuclear energy and Korea’s Samsung has made a similar approach in 5G. There are opportunities to work with countries in South and Southeast Asia to improve their export manufacturing capabilities and business environment.

Beyond this, the UK would benefit from asserting its own distinctiveness and appeal to China with more confidence and with a confidence that the risks can be addressed. A firm stance based on one’s own priorities pays dividends in any negotiation.

While the UK ranked only ninth as an export destination for China and 21st as a source of imports in 2018,
it remains the top destination for Chinese investment in Europe. The UK’s strengths in finance, education, heritage brands and technology are especially appealing. As US–China tensions continue, China may be less able to find substitutes for what the UK offers. The US is steadily less appealing for Chinese university students. China is increasingly worried that US financial markets may become less accessible for China and seek a complement to Hong Kong’s own international capital markets. A larger Chinese involvement in London’s financial markets is to be welcomed but will require oversight to ensure it does not become a risk factor in either institutional or market stability.

Working With Others

The UK is by no means alone in reassessing its commercial relationship with China. This brings both challenges and opportunities.

The Trump administration seems increasingly keen to push countries to choose between the US and China. Its actions also affect the choices open to the UK. US sanctions may threaten Huawei’s very viability as a 5G supplier: they played an important role in the UK’s updated 5G supplier risk assessment. The US may insist on a clause in any UK free trade agreement that links deal terms to US approval of agreements with others such as China.

But increased multilateral engagement among like-minded countries offers opportunities. The UK government has mooted forming a D-10 grouping between 10 democratic countries with an initial focus on 5G technology. There are also reports of extending the Five Eyes intelligence group to an economic alliance and developing an alternative to Huawei’s 5G. At the parliamentary level, the Inter-Parliamentary Alliance on China has recently launched. A possible future US Biden administration may join more actively in such multilateral efforts.

In sum, a range of policy actions are available to the UK to help manage risks in the commercial relationship with China, while continuing to reap the benefits of trade and investment. However, tradeoffs will not disappear. The relationship with China will remain complex, contradictory and ‘unusual’, more so than with many other countries. Current US pressure for a binary choice between the US and China makes matters more complicated still. The UK’s position will be stronger where it is clear on its own priorities and shows willingness to bear economic costs, where justified by other non-economic policy objectives. But economic considerations will loom large in the aftermath of the coronavirus pandemic and with uncertain EU trade relations ahead, further complicating the fine line between prosperity and security.

Andrew Cainey is a Senior Associate Fellow at RUSI.

Veerle Nouwens is a Research Fellow in the International Security Studies team at RUSI.

The views expressed in this article are the authors’, and do not represent those of RUSI or any other institution.