Battle royal

by Przemysław Myszka

"At its core, decoupling is really a contest being fought over the economy of the future." That is how the European Union Chamber of Commerce in China's *Decoupling. Severed Ties and Patchwork Globalisation* report ends. It is a tale of how the world's three biggest trading blocks, China, the European Union (EU), and the United States (US), are, it seems, increasingly distancing themselves from one another. The divide is most likely the sharpest and widest as far as anything digital is concerned, particularly on the China-US front, with Europe caught between a rock and a hard place. It provokes the question of whether globalisation is a thing anymore. Digital firewalls, export bans, trade tariffs, announcements of self-reliance and market dominance, cleansing of foreign technologies from one's systems, politicisation and weaponisation of trade, principal cultural values that exclude each other – all those and many more issues brought up by the Chamber are thorns in the flesh of overseas cooperation. If somebody is still up for handshakes and bows, that is. In President Xi Jinping's words, we may as well be entering the period of "assassin's mace," measures developed to pack a hard punch. It does not bode well for issues that require shared effort, like greening the global economy.

One of today's most noticeable signs of decoupling is the automotive sector's pains in sourcing semiconductors necessary for putting together electronic control units (ECUs) – the car's computers. First, with a 45% share (2018 data), the US dominates the semiconductor production market (China has 5%). Second, the Trump Administration has hit-listed China's Semiconductor Manufacturing International Corporation, the country's most advanced manufacturer. Third, the Entities List gives the US the option to cut off supplies to companies on the denylist as per the de minimis rule, namely if a certain threshold of a product's value derives from American sources (typically 25%, but the figure can change any time). It puts European automotive manufacturers sourcing chips from the US for their production in China in a difficult position (Europe's share in semiconductor output is 9%, so also insufficient to make up for the potential cut-off). It has led to a persisting crunch, with car production lines on hold and the available ECUs used to deliver higher-margin earning vehicles. Other industries, hence consumers, are also feeling the hard way what decoupling means, as evidenced by exorbitantly high prices of graphic cards (with tariffs, supply chain distortions caused by the pandemic, profiteers, and crypto-currency miners adding insult to injury in this concrete case).

Another politically motivated decoupling has taken the form of China's ban on the import of Australian coal. Although trade has lately been soaring between the two economies (+20% in 2018-2019), so have tensions; these varied from politicians exchanging insults via banning Huawei from Australia's 5G network to embargoing beef imports from Australia and hitting its barley exports with an 80.5% tariff. Concerning coal shipments, "As a result, during the first six months of 2021, Capesize and Post Panamax vessels performed 17% less Australia to China journeys, carrying 14% less in cargo volume, compared to the same period in 2020. Despite a reduction in trade between Australia and China, many vessels continued their voyages to China, and this resulted in significant numbers of laden bulkers stranded off Chinese ports, waiting to discharge their cargoes," reads VesselValue's ***2021 Port Congestion Report***. Among many, there was the Post Panamax *Topas*, which waited near Jingtang for eight months. China, wanting to increase its domestic

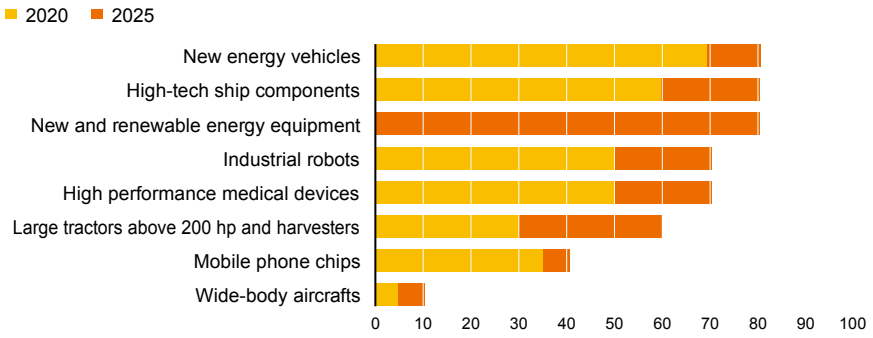
coal use, ended up troubled by energy outages and the need to take in coal from other, noticeably farther away located exporters such as South Africa. Australia has, in turn, had to find new outlets, chiefly Japan, South Korea and, interestingly, also coal-rich India.

Whole-of-nation system

Since Deng Xiaoping's reform and opening-up, China has been perceived as an enormous market with a potential purchasing power second to none. Meanwhile, owing to its massive labour force, the country has managed to position itself as the 'world factory.' Both still hold, even though some industries that rely on poorly paid employees, little-to-no regulatory oversight, and end- consumers' fixation with low price, have packed their bags and moved elsewhere in southeast Asia (think fast fashion). That said, the Chinese people's desire to consume products and services of increasingly higher quality and quantity has risen, too, alongside the will to produce and sell them, domestically and abroad.

According to the China Manufacturing 2025 initiative, the country will replace global competitors in several strategic technologies (Fig. 1). It stands to reason that China will continue its current practices to that end: selectively coupling with foreign partners in areas it lacks the know-how to eventually decouple when its national champions are sufficiently trained to first muscle out the competition from the Chinese market and then gain a foothold outside the country. "For example, high-speed rail technology in China developed quickly due to extensive state support combined with mandates for foreign technology transfers as a condition for market access. Once China's high-speed rail companies were confident enough, market access was tightened, though not through direct means such as a change to the legal regime

Fig. 1. The China Manufacturing 2025 initiative (semi-official percentage targets for the domestic market share of Chinese products)



Source for all figs. and tabs.: European Union Chamber of Commerce in China's Decoupling. Severed Ties and Patchwork Globalisation

Tab. 1. Export controls for certain technologies and sectors as proposed by US Department of Commerce

Biotechnology	Data analytics	Robotics
Artificial Intelligence and machine learning	Quantum information and sensing	Brain-computer interfaces
Position, navigation, and timing	Logistics[1]	Hypersonics
Microprocessor	Additive manufacturing	Advanced materials
Advanced computing		

[1] *Including mobile electric power, modeling and simulation, total asset visibility, and distribution-based logistics systems*



Photos: Canva

Tab. 2. Layers of decoupling

Macro decoupling	**Political**	The politicisation of business and geopolitical tensions is making the Chinese business environment increasingly difficult for foreign companies to navigate and act as catalysts for decoupling in other areas.
		The current impacts on European companies in China include increasing risks due to a souring of public opinion in home markets towards China, a drop in business sentiment, and uncertainty for operations due to the securitisation of business flows.
		The European business community in China is worried about the increased risk associated with 'political reciprocity' dynamics and the potential for more unpredictable tit-for-tat exchanges of economic restrictions resulting from political/diplomatic tensions.
	Financial	To further reform its financial system, China is working to integrate into the global financial system by establishing new investment channels into its capital markets and new opportunities for foreign financial institutions and investors.
		As long as China lacks a fully convertible capital account and an internationalised renminbi, its reliance on the USD remains its 'Achilles heel'. Efforts to internationalise both its currency and financial markets are likely to accelerate, but liberalisation is needed to do so.
		Any broad restrictions on access to the USD would amount to a 'nuclear' option that would bring considerable economic damage to the US and the rest of the world. A massive escalation of political tensions seems likely to trigger it, as happened with Russia and Iran.
Trade decoupling	**Supply chains**	Supply chains were already changing considerably in China before the COVID-19 pandemic or the trade war, with low-cost production moving elsewhere and most European companies expanding locally and further onshoring their supply chains.
		Although the trade war and the pandemic had been disruptive and expensive, still, European multinationals proved resilient, making shifts in supply chains to outright avoid many tariffs and maintain operations in China during its COVID-19 recovery.
		Many European companies report a desire to invest further in China and onshore supply chains for the local market to avoid potential disruptions. However, enthusiasm varies by sector based on how welcome they feel in the market.
	Critical inputs	Targeted restrictions on the sale and export of critical goods – such as semiconductors, related manufacturing equipment, software, or even rare earths – have become a more pressing concern for companies operating in China and globally.
		European companies have so far felt a limited direct impact due to export controls, but exposure is considerable for most. Pandemic-related shortages have shown how damaging lost or limited access can be, giving companies a taste of what the future may hold.
		Even companies with little to no risk may still be hit if their suppliers/customers can no longer source components or equipment from abroad. China's new export controls increase risks as well, as locally developed goods and solutions could be blocked from export.
Innovation decoupling	**Research & development**	Although China is an increasingly attractive R&D destination, a number of issues – some long-standing and intensified by decoupling trends, others that have recently emerged as a result – constitute barriers to European companies' R&D activities.
		In Europe, government stakeholders are re-considering their engagement with China on innovation cooperation, and the EU is working on tools to prevent unfair practices within its internal market.
		Consequently, European businesses will encounter increased difficulties when developing both their global and China R&D strategies.
	Standards	While access to standardisation bodies in China has improved considerably in recent years, European companies – particularly in key sectors – still face informal barriers that prevent them from effectively engaging in standards-setting in China.
		These access issues become all the more relevant when considering China's use of standardisation as a tool to advance its industrial and geopolitical agenda both at home and abroad.
		As a result, European companies may see their competitive edge being dulled and their market share reduced. At the same time, these standards-setting trends could also lead to distortion, or even fragmentation, of the global standardisation system.
Digital decoupling	**Data governance**	Data governance regimes in China and the EU already significantly restrict the transfer of data across the borders of these jurisdictions, creating significant compliance risks for companies.
		European companies anticipate that further restrictions on privacy and national security grounds will come into force soon, partly due to new legislation and judicial decisions in the EU and further measures in China.
		As a result, it will be difficult and risky to exploit the potential of data pools across the EU's and China's jurisdictional boundaries, even as the importance of data as a tool for innovation and efficiency-building grows.
	Network equipment	US efforts to decouple from Chinese telecommunications and network equipment and scrutinise any China-originated links found in network value chains under its Clean Network programme are impacting European companies and their offerings in the US market.
		China's rapidly expanding barriers to foreign telecommunications and network equipment value chains via requirements for 'autonomous and controllable' technology is pushing European players out of the market or into niche roles.
		In combination, these dynamics are inadvertently forcing companies to consider firewalling their China and US network operations from one another, with the former relying more and more on local solutions and the latter being stripped of China-sourced inputs.
	Telecommunication services	China's long-standing barriers to foreign telecommunications services and digital solutions have surged, especially regarding the digital technology at the centre of the fourth industrial revolution, which includes value-added telecommunication services like cloud and data centres.
		European companies are forced into joint ventures with Chinese counterparts to offer their digital solutions, which increasingly come from traditional industries outside of ICT/ telecommunications.
		As a result, European companies often have to integrate their products with locally sourced digital solutions to serve local customers, resulting in the provision of suboptimal offerings that are not globally interoperable.

governing foreign investment. Instead, the high-speed rail sector was subjected to one of a plethora of indirect barriers that have long plagued China's business environment. In this case, handpicked, state-owned national champions benefited from an unfair procurement system, which quickly gave them complete market share and the ensuing economies of scale that drove down their costs considerably," authors of *Decoupling* caution (read more about the impact of China's procurement system on European companies in our ***Second fiddle? Europe's participation in and response to the Belt and Road Initiative***).

While the issue at hand might sound like nothing more than the struck record of market rivalry, the involved blocks differ regarding what could be allowed as fair (let alone legal) competition measures. China and the US are poles apart, though also oddly on the same page regarding specific tactics. Even more strangely, the tit-for-tat trade war between the two has only obscured the bigger picture. Though eye-catching, chiefly thanks to President Trump's media ruffling, the hurling of trade tariffs did not cripple China-US trade. Companies, especially multinationals doing business in China, were quick to mitigate the political 'fury' coming from the other side of the Pacific. "One manufacturer had operations in Japan that were mainly for supplying the Japan/South Korea/Taiwan markets, while its China-based factories focussed heavily on exports to the US. The manufacturer simply had its Japan-based production export finished goods to the US and its China operations supply the Japan/South Korea/Taiwan markets," reads one of the examples from the Chamber's report. "The total volume of trade between the two economies did not change significantly and, if anything, increased," the authors add.

While not neglecting the importance of trading soybeans, coal or aluminium, the top tier economy of the future will be about all things digital, with products, services, and processes driven by Artificial Intelligence (AI), big data (BD), and the Internet of Things (IoT). As things stand today – or more precisely: get out of sync – the question is whether it will be American, European, or Chinese AI, BD, and IoT. In other words, we are dealing with an increasing techno-nationalism, "Whether it's the US' Clean Network proposal [purging Chinese technologies from American systems] or measures by Chinese authorities aimed at creating 'autonomous and controllable' technology [made in China solutions], it is all part of the same slippery slope: the technologies that are defining the future, and which are increasingly integrated into every sector of the economy, are being divided between two of the world's three largest economies, each of which has a growing firewall separating itself from the other." From a European perspective, this dichotomy is hard to swallow. On the one side, Facebook/Meta and the National Security Agency of the US spying on its citizens and foreign allies alike, a digital dictatorship on the other.

Tab. 3. The European Union Chamber of Commerce in China's Members' impact assessment of decoupling (% of respondents)

Area of decoupling	All negative (significantly negative)	No impact	All positive
Digital/telecoms	85% (34%)	12%	0%
Data governance	76% (24%)	16%	4%
Financial	70% (23%)	23%	1%
Supply chains	68% (23%)	23%	6%
Standards	68% (15%)	22%	5%
Self-sufficiency	64% (15%)	26%	6%
Political	59% (12%)	34%	0%
Critical inputs	49% (15%)	42%	3%

Drivers and layers of decoupling

While European companies may benefit from the China-US tug of war in the short-term, ousting its American rivals from Chinese deals, they might find themselves left on the back burner should their Asian counterparts decide it's time to proceed on their own.

The European public eye is also increasingly scrutinising the block's governments and companies' approaches to human rights issues. These include forced labour, with the Australian Strategic Policy Institute releasing in March 2020 the ***Uyghurs for sale: 'Re-education', forced labour and surveillance beyond Xinjiang*** report, in which the organisation identified 83 foreign and Chinese companies as allegedly directly or indirectly benefiting from the use of Uyghur workers (some 80k) outside the province of Xinjiang through potentially abusive labour transfer programmes. The report is alarming because it shows that abstaining from doing business in Xinjiang or relocating factories from the region is not enough – and that forced labour isn't a matter of geography, as if erecting a production site a stone's throw from the province's borders would fix anything, but supply and demand. And there are the Hong Kong protests; for example, Cathay Pacific, the flag carrier of Hong Kong, was compelled to suspend staff that appeared to have displayed support for the pro-democracy movement. That is not to mention China's long-standing, and it appears nowadays – hardening, line of treating Taiwan as part of the People's Republic of China, with a harsh backlash against anyone naming or just hinting at the island as an independent country. The actor John Cena has recently become a meme after professing love to China in response to calling Taiwan a country – in all probability to prevent getting the ninth episode of the *Fast & Furious* off mainland China cinemas, Hollywood's biggest overseas market. Meanwhile, Lithuania and Taiwan's intention of establishing representative offices has prompted China to discipline the Baltic country by scratching train stops in Vilnius, thus turning Lithuania into a transit country only for the New Silk Road. Transport companies complain that Lithuanian containers now have to be hauled from the border with the Kaliningrad Oblast.

The authors of *Decoupling* also write, "Catalysed by the COVID-19-induced disruption of global supply chains, there is a growing debate about vulnerabilities associated with a perceived 'overdependence' on China with regard to imports of certain critical products (rare earths, personal protective equipment, or the battery, hydrogen and cloud technologies, among others)." Then again, there is this sense of hope that trade and business between China and the EU will, this way or another, continue to flourish, politics-no politics. One 'coupling' example from the Baltic Sea region would be the set-up of several facilities to cater to the battery market, posed to grow as Europe's electricity generation shifts towards renewables. It all started with Northvolt Ett, a lithium-ion battery production site under construction in Skellefteå in northern Sweden (annual capacity of at least 32 GWh by 2024, with the potential to expand to 40 GWh in the future). The Swedish battery producer will also establish – on the



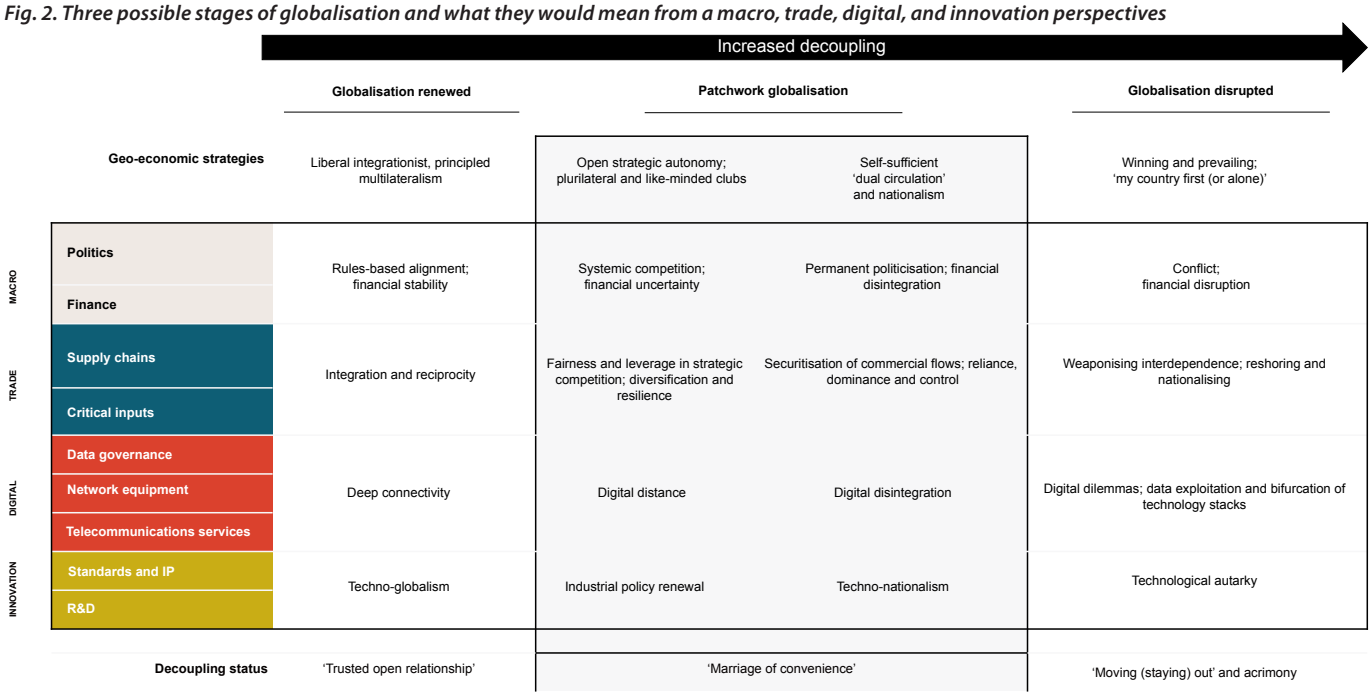
territory of the Pomeranian Investment Centre, near the Port of Gdańsk – what it says will be Europe's largest energy storage factory. The 50k m²-big facility will be set up in two stages, with works on the first to commence in autumn 2021; initially, from 2022, the plant will have an annual output of 5.0 GWh of energy storage modules and packs, up to a total capacity of 12 GWh after the completion of the second phase. Third, Shenzhen Senior Technology Material will erect a production line, its first outside China, at the Svista industrial estate, with supplies going by rail via the Eskilstuna Intermodal Terminal. Once operational, the Senior Eskilstuna factory will provide the Northvolt Ett with separators. The involved seaports, Gdańsk and Gothenburg, will benefit from handling supplies coming from overseas to 'fuel' the production lines. The Swedish Scanlog has been contracted to take care of the logistics for Northvolt's activities in the country, ramping up its capabilities in Gothenburg to account for the increase in shipments.

However, the overall feeling is that the business environment in China has become more politicised lately, thus prone to abrupt change as per the shifting line of the Chinese Communist Party (CCP). According to the Chamber's *Business Confidence Survey 2020*, some 43% of respondents "[...] stated that China's business environment had become more political over the previous year, with almost half of those saying that external political pressure was being exerted by the Chinese Government and media." The report furthers, "If a country has political tensions with China, the Chinese public and government tend to scrutinise its businesses more. The greater the tensions, the more exposure a company has to negative messaging on Chinese social media [...]."

While experts debate what constitutes the "**Chinese State Capitalism**," the Chamber notes a profound shift from Deng Xiaoping's times, namely that CCP members are penetrating companies across the board. It is especially problematic for those European enterprises that must form a joint venture with Chinese companies to enter the market. Atop that sits the necessity to pick from two unprepossessing options: to start a JV with your competitor or partner with somebody outside the sector, hence receiving no added value. The Chinese history of industrial espionage and disregard for intellectual property would further take it beyond palatability; if it hadn't been for the princely revenues of China's internal market, that is. Of course, not all sectors of the Chinese economy are subjected to such a dilemma. Yet, those picked to attest of the country's coveted dominance – unavoidably so. As such, it is all the more thought-provoking to see the recent opening up of the lucrative Chinese financial services sector. Albeit done cautiously, it has included events like taking full ownership of its Chinese securities business by Goldman Sachs. On the flip side, "[...] 16 per cent of members reported having felt compelled to transfer technology to maintain market access, in strategic industries like medical devices, aerospace and aviation, and environment, this number rose to close to a third of respondents." Are we up for the repetition of the high-speed rail scenario then?

The global financial system will most likely be another of the battlegrounds between China and the US. The latter has dominated it through its currency, whereas the Chinese renminbi (RMB) struggles internationally. "Despite the size of China's economy and the RMB being upgraded to an international reserve currency by the International Monetary Fund in 2015, the share of RMB payments in cross-border transactions was just 1.66 per cent in October 2020. [...] Even China's flagship BRI [Belt and Road Initiative] projects are primarily being funded in USD," reads the

Fig. 2. Three possible stages of globalisation and what they would mean from a macro, trade, digital, and innovation perspectives



Chamber's *Decoupling*. Losing control over its currency, including exchange rate and possible outflow, makes the CCP sit on the fence between full liberalisation and tight domestic supervision.

Given its upper hand position, the US has, in theory, the 'nuclear' option of weaponising the dollar by "[...] preventing financial institutions from offering their USD clearing services to Greater China-based clients through increased sanctions." Should political and security matters take precedence over economic considerations, the Chamber cautions, shock waves will hit the global economy. Economically speaking, China isn't Russia or Iran, against whom the US has exercised the currency-cut-off measure, and the fallout would severely affect the attacker, too.

In the meantime, the US has put into effect lesser, although caustic, means. American investments in entities having links with the (rising in power) Chinese military are banned. The US administration has also reasoned with pension funds to stop investing in Chinese stocks. The European Council has taken similar steps, "While not mentioning specific countries or regions, the regulation [*Council Regulation 2020/1998 of 7 December 2020 concerning restrictive measures against serious human rights violations and abuses*] gives the Council the possibility to freeze and restrict access to funds and economic resources for 'natural or legal persons, entities or bodies responsible for, providing support to or otherwise involved in serious human rights violations or abuses, as well as those associated with the natural and legal persons, entities and bodies covered'," mentions the Chamber.

Technical-turned-political

Standards of business conduct, research and development, and privacy also differ, including how data are handled. Reciprocity is hardly a thing when European companies have to hand over their data sets but cannot transfer information outside Chinese borders. It put sand in the wheels of multinationals, who miss out on the opportunity of working on combined globally scaled data pools from Europe and China (think pharmaceutical companies or research & development on autonomous vehicles).

On the other hand, European standards provide for a borderless flow of data – something that might very well change soon, as the von der Leyen Commission weighs the pros and cons of Europe's openness in this regard. "Government regulations in this domain [data management], originating from both China and the EU, have already caused disruptions to cross-border data flows, as different jurisdictions impose sweeping data localisation requirements due to a combination of privacy, national security and economic concerns," the Chamber observes.

The Chinese are aware of it and are preparing accordingly by instituting their standards, intentionally defying international standard-setting bodies, or pushing their standards through them. "A discipline traditionally considered highly technical, standardisation has become increasingly politicised in recent years," the Chamber notes. In principle, standards developed in China aren't, for want of a better word, "bad" just because they are Chinese. There are, however, certain red flags to take account of. Among them is that non-Chinese parties are generally excluded from standardisation activities in China; the top three restricting issues are unclear access procedures, unavailability of information, and the inability to obtain full voting rights. The rate of adopting international standards has also gone down in China, the Chamber reports. At the same time, convergence between domestic and international standards remain "extremely low." Finally, "In areas such as ICT [information and communications technology], cell and gene therapies, smart manufacturing and new energy vehicles [...], an increase in domestic standardisation activities has been observed by European Chamber member companies."

The BRI is also used as a means for promoting Chinese standards outside the country's border, "If a project-recipient country accepts the use of Chinese standards, the immediate effect will be a drastic reduction in the chances for foreign companies to participate in such projects." It could also "[...] result in an increased economic and technological



dependence of these third countries on China and, in a worst-case scenario, contribute to the fragmentation of the global standardisation system."

The crippling

According to the Chamber, if left unchecked or further rubbing salt into wounds, all of the above will result in European companies deciding to leave the Chinese market or adapt. "[...] the global technology ecosystem has already deteriorated to the point where some companies are seriously looking into which of the unappealing options available to them is the least damaging. Others are beginning to wake up to the fact that the date for exiting China may be approaching," says the Chamber.

Enterprises will fall into one of three categories, starting with the 'Business Class,' which will include companies encouraged by the Chinese to strengthen their foothold in the country, like semiconductor manufacturers or software developers. Then the 'Economy Class,' companies whose presence neither poses a threat nor an advantage to CCP's plans (car producers, among many). Lastly, the 'Cargo Hold' type: enterprises at increasingly higher risk of getting the wolf ticket (such as ICT).

Choosing to stay will necessitate going down two exclusive paths: adopting a dual-system model or incorporating a flexible architecture, both disadvantageous compared to how companies would prefer to operate. The first would involve setting up two separate supply chains and research & development systems – one to serve China (and, future-wise, its "dependencies"), the other for the rest of the world (if the rest won't fall victim to Balkanisation, that is). The Chamber predicts, "[...] the immaterial costs of the technology war will be extensive. Innovation that drives efficiency gains, as well as new goods and services, will take a significant hit. This is not only due to the cost of running dual R&D systems (every euro spent to localise into one or the other market is one less euro spent developing new technology at the global level) but also due to the growing isolation of data pools, which diminishes the ability of companies to build efficiencies and find new solutions." The other possibility would be to deliver products and services as neutrally as possible for the global market, customising them to suit the particular landscape of regulations, standards and politics, something which certainly sounds easier said than done.

The Chamber's *Decoupling. Severed Ties and Patchwork Globalisation* soberly summarises the situation by stating, "There is no returning to a period in which globalisation is renewed to some pre-Trump ideal, because such a time never really existed – China was not coupled with the rest of the world economy in many areas, and its self-reliance drive that is providing a backdrop to the current state of affairs had already been well in place for more than four years." Suppose governments cannot iron out a risk-managing framework. In that case, the Chamber bodes no good to the global economy as "[...] entire industries will become completely impenetrable due to intensive restrictions imposed in the name of national security or self-reliance. The unthinkable result would be the crippling of global value chains, economies of scale and innovation systems."

Resources would go for coping with what was an avoidable but now highly irreversible reality, with every dollar or renminbi allocated for 'cleaning networks of non-autonomous and uncontrollable' technologies being one less spent on development. But maybe that's the idea behind the new arms race – bleeding out the opponent to seize the means to advance the agenda further. One's scheme, precisely. "The conquered mourns, the conqueror is undone." ■