China’s Political Economy and International Backlash: From Interdependence to Security Dilemma Dynamics

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**ABSTRACT**

Contrary to expectations that economic interdependence might lessen security conflict between China and the U.S. and its allies, much of the contestation between China and several OECD countries has focused on firms and economic links. This paper explains the intensification of economic contestation between China and several OECD countries by showing how changes in China’s domestic political economy have generated security dilemma dynamics. Since the mid-2000s, the Chinese Communist Party’s approach to the economy has become increasingly securitized, such that the developmental goal of economic growth, which required accommodation of the private sector, has been overshadowed by a strategy of political control and risk management for regime survival. We term these changes “party-state capitalism,” and identify two signature manifestations: 1) expansion of party-state authority in firms through changes in corporate governance and state-led financial instruments; and 2) enforcement of political fealty among various economic actors. Together, these trends have blurred the distinction between the state and private capital and resulted in several forms of backlash, including intensified investment reviews, campaigns to exclude Chinese firms from prominent sectors, and novel domestic and international institutions to address perceived threats from Chinese actors. We conclude that the uniqueness of China’s model has prompted significant reorganization of the rules governing capitalism at the national and transnational levels.

**Keywords:** China political economy, economic interdependence, security dilemma, state capitalism, U.S.-China relations

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“Our party faces unprecedented challenges and problems in leadership and capacity, including challenges in governance, in reforms, and in the market economy…Meanwhile, challenges from the international context are perennial, complicated and severe. We also face (domestic) threats due to mental slack, isolating ourselves from our people and from corruption, etc.”

- Chinese President Hu Jintao, July 1, 2011, Chinese Communist Party’s 90th Anniversary

“[T]here is no real difference between a Chinese state-owned enterprise and a ‘private’ Chinese firm in terms of the national security risks that exist when a U.S. company partners with one.”

- U.S. Senator John Cornyn, 2018

Over the past decade, high profile conflict between China and OECD countries has centered on not only the role of the state, but also that of Chinese firms. This trend runs counter to the expectations of international relations (IR) literature that focuses on security rather than economic affairs as the locus of inter-state competition. In studies examining “China’s rise” in the international system, economic interdependence is imagined to facilitate cooperation while more traditional security issues, such as Taiwan’s status and territorial tensions in the South China Sea, have been focal points for potential conflict. Nation-states do, of course, have territorial, political, and ideological disputes with the People’s Republic of China (PRC) government itself, yet legislatures and regulators have taken punitive actions against Chinese businesses, and government officials and diplomats have coordinated similarly. Within a short period, the European Commission went from describing Chinese firms’ economic activities in developed democracies as a “reciprocal benefit,” to viewing such engagement as a major security liability.¹ Why? We propose that significant evolution of China’s political economy and subsequent reactions from many advanced industrialized countries are best explained in terms of security dilemma dynamics. Specifically, the Chinese Communist Party’s (CCP) actions to ensure regime security—actions responding to perceived domestic and external threats—generated insecurity in other states, causing them to adopt measures to constrain Chinese firms. These reactions have led to security competition between China and other states. The emergence

of security dilemma and security competition dynamics in economic relations is surprising because economic interdependence is typically expected to mitigate interstate conflict. Security competition with China in the economic realm thus offers an opportunity to expand conceptions of security dilemmas and competition, and indeed security, to include contestation over firms and the consequences of interdependence, especially when clear lines between military and civilian uses of technology, communications systems, and data are not easily drawn.

Moreover, we contend that explaining the backlash against China requires understanding the evolution of its economic model to what we call “party-state capitalism.” Since the late 2000s, China’s political economy has shifted from a familiar form of state capitalism to one in which the party-state has adjusted and expanded its role in the economy. This change has been driven by the leadership’s uncertainty about its economic model, heightened anxiety after the global financial crisis, and a more generalized perception of domestic and external threats. The CCP’s approach to economic governance became “securitized,” such that political control over firms and risk management are prioritized over rapid growth. We identify two signature manifestations of “party-state capitalism:” 1) significant expansion of party-state authority in firms through changes in corporate governance and state-led financial instruments; and 2) the drawing of political “red lines” to enforce political fealty by various economic actors.

A major outcome of this change in China’s domestic political economy has been blurring in the party-state’s treatment of state-owned and private capital and ensuing lack of clarity as to where the party-state ends and firms begin. The evolution of China’s model has elevated economic interdependence and the actions of both Chinese and international firms to a central place in national security deliberations. By pointing to the economic origins of a security dilemma, this paper reveals how the unique challenges of party-state capitalism in China have spurred national governments and international institutions to reshape their own economic strategies in ways that impact the future of globalization.

The paper proceeds as follows. We start by making the case that economic interdependence, contrary to the pacifying and reassuring role that it was expected to play, has been a critical source of insecurity for both China and its global economic partners. The next section draws on the security dilemma logic to theorize how important changes in China’s domestic political economy over the past decade have resulted in backlash and spiral dynamics. The blurred boundary between the Chinese state and firms has generated perceptions of insecurity by other states because increased party-state economic control is perceived as a new security capability and has fueled anxiety about China’s intentions to weaponize economic relations. We then show how security competition took the form of global economic backlash.

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3 Domestically, the CCP’s emboldened role threatens to alienate capitalists, on whom the country has depended for growth and innovation. We discuss this, and other outcomes of party-state capitalism, elsewhere. See Margaret Pearson, Meg Rithmire, and Kellee Tsai, “Party-State Capitalism in China,” *Current History* Vol. 120, Issue 827 (September 2021): pp. 207-213, doi.org/10.1525/curh.2021.120.827.207.
against Chinese firms. In response to China’s party-state capitalism, the U.S., Europe, and other countries have established or revitalized investment review institutions; endeavored to restrict Chinese “national champion” firms; and initiated policies and novel institutions in response to its unique economic system. We conclude by reflecting on the implications of this security dilemma for global economic relations.

Before proceeding, we note several points about the scope of our analysis. First, backlash against China is concentrated in the major developed economies. The U.S. has enacted the most regulatory and legislative measures, and, although they vary in their responses, other OECD members have undertaken similar efforts. On balance, however, most countries have been involved in a more limited way, and some observers from the developing world have expressed a preference that their countries avoid confrontational actions. Second, only a sub-set of China’s economy operates at the forefront of party-state capitalism, eliciting international responses. Of primary relevance are large companies in strategically crucial sectors, such as technology and communications, or with dual use capabilities. Small and medium enterprises, particularly those with a domestic focus, are less affected by the securitization of the economy described below. Finally, while the security dilemma dynamics analyzed here represent a novel and consequential conflictual trend in the global economy, we recognize that other arenas of economic tension are not well explained in security dilemma terms because they are not about security, but rather classic domains of economic competition. We return to this idea below.

Economic Interdependence as a Source of Insecurity

For decades, IR scholarship has explored scenarios for Sino-U.S. conflict in the context of China’s growing influence. At one end of the theoretical spectrum, John Mearsheimer’s formulation of offensive realism depicts militarized rivalry between the U.S. and China as inevitable, as a dominant U.S. seeks to diminish a rising China’s power. By contrast, liberal institutionalism proposes that economic interdependence with China offers a promising basis for peace, reassurance, and cooperation in security relations. Scholarship in this vein suggests that

4 Domestic politics and different trade and economic relationships with China create variation in countries’ reactions to Chinese firms. European countries, for example, differ from one another and from the U.S. This paper focuses on the commonalities of OECD reactions in time and direction. Explaining variation among countries is beyond the scope of the paper, but would be part of a promising research agenda on how China’s economic model has generated political economic changes abroad. We return to this idea of a research agenda in the conclusion.


economic cooperation can reduce the propensity of military conflict arising from a security dilemma.\(^8\) In short, the complex interdependence that underlies a liberal global economic order, especially between the world’s two largest economies, has long been viewed as a force for cooperation or even a mechanism through which the U.S. might change China’s behavior.\(^9\) To the extent that China’s economic rise has prompted warnings of rivalry or conflict, they are based primarily on a structural realist logic that focuses on shifts in relative power among states.\(^10\) Such accounts highlight the size of China’s economy and its relative economic power vis-à-vis other states, leading to hypotheses about whether China will achieve the level of technical prowess required to challenge U.S. military hegemony.\(^11\)

Given this theoretical context, the empirical reality that economic interdependence constitutes the widest and as yet the sharpest point of conflict in China’s relations with the U.S. and other industrialized economic partners is puzzling. Political leaders in several countries have for years criticized China’s “trade-distorting subsidies,” currency practices, and various elements of its “state capitalist” system. Yet a new and more urgent concern that economic engagement with China constitutes a security risk has emerged, and quickly accumulated bipartisan support in OECD countries. As detailed below, several countries have adopted or expanded institutions to review both inward and outbound investment for security implications. China’s national champions, including private firms, have been targeted by tools ranging from economic sanctions and entity listings to diplomatic campaigns. In response, China has threatened to withdraw investment from countries that exclude its firms from, for example, 5G deployment, or limited market access for multinational firms critical of China on political issues.

How has economic interdependence become the heart of the U.S.-China conflict? After decades of arguments that complex interdependence would temper misperceptions and hostilities between China and other states, how and why did economic ties become the primary site of insecurity? Others have observed that economic interdependence can produce conflict and vulnerability.\(^12\) When there is significant asymmetric power among states, tensions may be


\(^9\) Ikenberry, “The Rise of China.”

\(^10\) For example, Mearsheimer, “Can China Rise Peacefully?”


manifested in what Henry Farrell and Abraham Newman call, “weaponized interdependence,” whereby states with political authority over critical hubs “use global economic networks to achieve strategic aims.” Yet the rapidity and severity with which economic interdependence became a source of global contestation for China begs for explanation.

We argue that escalating tensions over economic interdependence with China are best explained in terms of security dilemma dynamics triggered by changes in its domestic political economy since the late 2000s. These changes created perceptions of a security threat in other wealthy countries, and inspired actions designed to counter the perceived threat. Security dilemma logic posits that the means by which one state tries to increase its own security decreases the security of other states. In traditional security dilemma analysis, efforts by one state to increase its military capability increases insecurity in others, especially when the first state’s intentions about use of the new capability are neither clear nor credible. Paradoxically, then, one state’s efforts to enhance its own security will fail insofar as the responses by other states – arms buildups – actually heighten the first state’s insecurity. The result is competition, an arms race spiral and, at worst, war. Drawing on this classic logic, we argue that the content of China’s domestic political economic practices, how they have changed over time, and perceptions of the sources of those changes have generated precisely the doubts about China’s intentions and fears about its capabilities that contribute to security dilemmas. In making this argument, we offer three contributions to the security dilemma concept and to understanding the U.S.-China conflict. We show, first, that when a regime with global significance perceives insecurity and acts to secure itself, international actors are more likely to interpret those domestic actions as threatening or to reevaluate that country’s intentions. In other words, we highlight that domestically-oriented actions, and ones non-military in nature, can trigger a security dilemma.

Second, we demonstrate the need to take economic relations seriously as sources of insecurity and security dilemmas. Here, we join Farrell and Newman and others in pushing scholars of international security to consider economic ties and globalization, but we also insist that domestic economic practices have global security implications, particularly in highly globalized states. Much analysis of China in the international system has been dominated by assessments of China as a “newly aggressive” power or “revisionist state” presenting a challenge to the “rules-based international order.” Yet many of these works, both those portraying China as newly aggressive and critiques of that interpretation, focus on conventional realms of security studies, such as China’s territorial disputes, maritime activities, and behavior in international institutions. Our contribution is to identify a set of changes since the late 2000s in China’s domestic economic practices, including by its firms, that other governments interpret as evidence of enhanced capabilities or “greedy state” behavior. This perception, in turn, has given rise to a security dilemma with implications for the global liberal order that facilitated economic interdependence in the first place.

Third, we highlight the central role of firms, not just states, in security dilemma dynamics when they envelop economic globalization issues. As detailed below, China’s political economic changes have been interpreted, sometimes accurately, as incorporating firms, no matter their ownership, into China’s security resources and capabilities vis-à-vis other states. Because of blurred boundaries between the party-state and Chinese firms, and also the security relevance of data and dual use technologies, the actions of firms have security implications for states and can be the sites of security competition and spiral dynamics. In short, China is engaged in security dilemma and security competition dynamics with several countries in the international system not in spite of economic interdependence, but rather, because of it.

**China’s Domestic Anxieties and Actions**

Following Mao Zedong’s death in 1976, initiation of economic reforms provided the basis for China’s unprecedented growth. Although reforms led to privatization and downsizing of the state-owned sector, generations of reform-era leaders continued to reiterate the importance of state guidance in debates about China’s direction. By the mid-1990s, a Chinese version of...
“state capitalism” had taken clear shape and was widely considered an exemplary form as practiced under authoritarianism. Broadly speaking, “state capitalism” refers to mixed economies in which the state retains a dominant and relatively autonomous role even amidst markets and privatization. Classic state capitalist tools include state ownership, subsidized credit, industrial policy, and appointment of managerial actors. Contemporary observers of state capitalism interpret state interventions as being deployed to bolster geo-strategic and/or economic competition in globalized sectors.22

As of the mid-2000s, China’s state capitalism primarily aimed to manage and enhance the efficiency of large state-owned enterprises (SOEs) in sectors deemed crucial to China’s security at home and abroad (e.g., energy, telecommunications, and finance). Reformers also urged large SOEs to create wealth for the party-state, often through market consolidation.23 During this period, the nature of state capitalism in China was broadly consistent with its usage in comparative political economy, which cast state capitalism as motivated by developmental or redistributive logics. A strong state was needed to overcome “economic backwardness,”24 and to manage industrial growth and global competition.25

Meanwhile, the CCP’s “core interests” continued to center on safeguarding the survival of a CCP-led regime.26 Beijing’s conceptualization of national security has always encompassed “the security of the Chinese Communist Party and its ability to govern Chinese society,” including through “stability maintenance.”27 During the Hu Jintao era, however, domestic and international events contributed to a changed approach to regime security that proactively sought to prevent risks rather than simply “maintain stability.”28 Economic governance also shifted to M.E. Sharpe, 1994); Isabella Weber, How China Escaped Shock Therapy: The Market Reform Debate (New York: Routledge Press, 2021).

focus on threat-prevention, which we document in the section to follow. A combination of perceived internal and external threats spurred a reconfiguration of its political economy to a model that we term, “party-state capitalism.” We discuss the CCP’s turn toward a more proactive strategy to ensure regime survival, first addressing precipitating factors for such a turn and then identifying domestic manifestations of the new model.

**Generalized Threat Perception**

Ample literature on Chinese politics has elucidated how the CCP’s fixation on domestic stability has increased steadily since the late 2000s. Especially following large-scale protests in Tibet (2008) and Xinjiang (2009), concerns about domestic “terrorism” engendered repressive party-state responses. Upon assuming PRC leadership on the heels of a global financial crisis, Xi Jinping directed the party’s internal attention on regime decay and collapse elsewhere to avoid such fates in China. The USSR’s collapse figured prominently in Xi’s public speeches and instructions to rank and file officials. Mass mobilization through “color revolutions” in Eurasia in the mid-2000s and Arab Spring in 2010-2011 renewed the party’s anxiety about popular demands for regime change with possible external influence. Heightened alarm over perceived internal threats to the CCP’s political power led its leadership to strengthen the regime’s coercive capacity. Although Xi’s “China Dream” carries a triumphalist sentiment, we interpret this nationalist rhetoric as directed primarily at domestic audiences, rather than addressing the party-state’s underlying insecurity that pre-dated Xi’s rise.

Even as debate continues on whether the CCP’s grand strategy toward the global system has changed under Xi, consensus exists that China’s own perception of its security environment has shifted. Following the global financial crisis, the CCP became preoccupied with securing the resources needed for the next stage of growth, fearing technological inferiority and dependence. Beijing’s approach to handling perceived domestic and external threats to its economic stability was elevated to the realm of national security and regime survival, which, we argue, transformed its model of domestic political economy.

**Economic Insecurity**

Various economic developments contributed to changes in China’s model, including slower growth and the end of required WTO liberalization plans in 2005-6. Yet it was the global

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31 Goldstein (“China’s Grand Strategy”) observes that a “less forgiving security environment” influenced Xi’s efforts to reform the global system and resist challenges to China’s core interests.

financial crisis and its aftermath that sparked an acute sense of insecurity, as the sudden drop in external demand highlighted China’s dependence on exports. The Hu Jintao-Wen Jiabao administration (2002-12) responded with a massive stimulus package. While this investment boosted GDP in several localities, rapid rise in public and corporate debt deepened concerns about financial instability and the sustainability of China’s existing model. Domestically, many economists and policymakers concluded that the country should reduce its vulnerability to external markets. Upon assuming office in 2012, Xi cautioned that China’s “new normal” required reorientation of its economic model. Lower growth should be expected, and the country should reduce reliance on exports by emphasizing domestic consumption to drive development.

Under Xi’s leadership, the party-state has specified economic stability as a core component of national security and sought to address financial risks and malfeasance through the state’s repressive apparatus, i.e. anti-corruption prosecutions, detentions of state and private actors, and firm nationalizations, rather than regulatory and macroeconomic tools alone.

Compounding domestic sources of economic insecurity, China’s leaders became increasingly apprehensive about dependence on western technology. Over 2013-14, Edward Snowden’s revelations that the U.S. had deployed a cyber-attack on Iran, and that the National Security Agency had breached Huawei’s servers to access proprietary corporate information, fueled a sense of alarm. Establishment of China’s Central Cyberspace Affairs Commission (CCAC) in February 2014 was a proximate reaction. CCAC described the Snowden incident as “a wake-up call for all countries in the world that without cybersecurity, there can be no national security.” A Chinese Academy of Engineering academician echoed the dangers of relying on foreign equipment: “[D]espite the cost advantages of domestic equipment, nearly 80% of our country’s backbone network equipment is Cisco products, which obviously provides

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34 Xi Jinping’s Report at the 19th CCP National Congress, China Daily, October 18, 2017, http://www.chinadaily.com.cn/china/19thcppcnationalcongress/2017-11/04/content_34115212.htm. Premier Wen Jiabao expressed similar ideas before Xi came to power. In March 2010 Wen said: “There is insufficient internal impetus driving economic growth; our independent innovation capability is not strong; there is still considerable excess production capacity in some industries and it is becoming more difficult to restructure them; while the pressure on employment is constantly growing overall, there is a structural shortage of labor; the foundation for keeping agricultural production and farmers’ incomes growing steadily is weak; latent risk in the banking and public finance sectors are increasing; and major problems in the areas of healthcare, education, housing, income distribution and public administration urgently require solutions…. We urgently need to transform the pattern of economic development…onto the track of endogenous growth driven by innovation.” 2010 Report on the Work of the Government, delivered at the 11th National People’s Congress (NPC), March 5, 2010, https://china.usc.edu/wen-jiabao-2010-report-work-government-march-5-2010.


convenience for implementation of ‘prism gate’ monitoring programs.”  

In addition, a group of executives wrote to Beijing’s leaders warning that China’s reliance on foreign mainframe computers in finance, telecommunications, energy and government affairs put national security at risk. In March 2014, “protecting cybersecurity” appeared in the Premier’s Party Congress Work Report, and a suite of new laws ensued to expand party-state control over cybersecurity.  

The damaging effects of the global financial crisis, combined with social instability and widespread corruption, called for policy responses. Intellectuals associated with the “New Left” sought solutions to societal ills associated with markets and privatization, especially inequality and bourgeois decadence. Concurrently, pro-reform observers hoped that Xi’s seeming embrace of greater marketization would further curb state intervention. But that did not transpire. The CCP has instead extended its authority and reach—organizationally, financially, and politically—into China’s domestic and foreign economic relations. Prior developmental goals have increasingly been overshadowed by initiatives that place politics in command and state capitalism in the service of the regime’s political survival. Broadly, the party is seen to be the solution to all potential threats. As Joseph Fewsmith has argued, “Xi has asserted the primacy of the party, inserting ‘the party controls everything’ into the party constitution for the first time.”

**LEGAL AND DEVELOPMENTAL SECURITIZATION**  
The party’s expanded reach and profound sense of insecurity found their way into a set of laws and a development strategy of “military-civil fusion” that reflect increased “securitization,” meaning the application of a security logic to the political economy: economic issues have become national security issues in the eyes of China’s party-state, and hence potentially threatening capabilities to other states. In combination, these new laws and policy priorities

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37 Ibid.  
43 PRC state documents increasingly cite “economic security” as a key feature of “comprehensive national security.” Helena Legarda, “China’s New International Paradigm: Security First,” in *The CCP’s Next Century: Expanding
represent institutional means to elevate economic activities to the level of national security. Most notably, recent laws compel “firms, individuals and other organizations,” to provide information or support to the government if that information is deemed to have security implications. The 2017 National Intelligence Law explicitly states,

An organization or citizen shall support, assist in and cooperate in national intelligence work in accordance with the law and keep confidential the national intelligence work that it or he knows (Article 7).44

The intelligence law was passed following a revamp of China’s legal system related to security, including the sweeping 2015 National Security Law that specified economic security (Article 19) and financial stability (Article 20) as key pillars of “national security” requiring state protection.45 (Table 1 lists the main national security laws that obligate companies.)
Table 1: Laws Ascribing National Security Roles to Chinese Firms

<table>
<thead>
<tr>
<th>Name</th>
<th>Year</th>
<th>Notable Clauses</th>
</tr>
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<tbody>
<tr>
<td>Counterespionage Law</td>
<td>2014</td>
<td>Citizens and organizations shall facilitate and provide other assistance to counterespionage efforts (Article 4); state protects and rewards those who make major contributions to this effort (Article 7).</td>
</tr>
<tr>
<td>National Security Law</td>
<td>2015</td>
<td>Establishes “economic security” and “financial stability” as pillars of national security (Articles 19, 20). Enterprises, among other organizations, have responsibility and obligation to preserve national security (Article 11), and shall cooperate as required by national security efforts (Article 78).</td>
</tr>
<tr>
<td>Counter Terrorism Law</td>
<td>2015</td>
<td>Telecommunications operators and internet service providers shall provide technical interfaces, decryption and other technical support assistance to state organs conducting prevention and investigation of terrorist activities (Article 18).</td>
</tr>
<tr>
<td>Cybersecurity Law</td>
<td>2016</td>
<td>Network operators shall protect cybersecurity, accept supervision from the government and public, and bear social responsibility. (Article 9) Network operators shall provide technical support and assistance to state organs related to national security (Article 28).</td>
</tr>
<tr>
<td>National Intelligence Law</td>
<td>2017</td>
<td>Organizations and citizens shall support and cooperate with the state intelligence work (Articles 7, 14).</td>
</tr>
<tr>
<td>National Security Law of Hong Kong</td>
<td>2020</td>
<td>Criminalizes separatism, subversion, terrorism, and collusion with foreign countries or “external elements” deemed to endanger national security. Applies to “any institution, organization or individual” in Hong Kong (Article 6), or outside of China (Article 29).</td>
</tr>
<tr>
<td>Anti-Foreign Sanctions Law</td>
<td>2021</td>
<td>Organizations/entities/individuals involved with “discriminatory restrictive measures against Chinese citizens and organizations” may be subject to countermeasures (Article 4); organizations/entities/individuals must implement anti-foreign sanction measures (Article 11); organizations/entities/individuals must not aid in implementing sanctions imposed by other countries (Article 12).</td>
</tr>
<tr>
<td>Data Security Law</td>
<td>2021</td>
<td>Expects departments, industry organizations, enterprises, and individuals to protect data security (Article 9); prohibits domestic entities from providing critical data to foreign countries (Article 31).</td>
</tr>
</tbody>
</table>


Accompanying laws mandating firm cooperation with intelligence and security operations, Beijing adopted a new “military-civil fusion” strategy. Issued by the CCP, PRC State Council, and the Party’s Central Military Commission in 2015, the 13th Five-Year Special Plan for Science and Technology Military-Civil Fusion Development called for “integrated
development of economic construction and national defense construction.”  
46 The new strategy aimed to build a modern and efficient military by involving the private sector in research and development (R&D), manufacturing, and logistics to benefit the wider economy through commercialization of military technology.  
47 Implementing this holistic developmental strategy would require breaking down legal and institutional barriers between commercial and military technology to strengthen R&D coordination among military research institutes, state-owned defense companies, universities, and the private sector.  

As a complement to military-civil fusion, the “Made in China 2025” (MiC2025) initiative was introduced in 2015 to upgrade the country’s industrial capacity and promote indigenous innovation in core technologies, including artificial intelligence (AI), 5G, semiconductors, biotech, aerospace, and electric vehicles. An explicit goal of this industrial policy was to reduce perceived risks associated with China’s reliance on foreign technology by 2025. MiC2025’s nationalistic discourse about “catching up with” and “surpassing” (ganchao) the west in technological capabilities and reducing dependence on global supply chains would be met with external alarm and criticism, especially when target sectors were potentially “dual military-civilian use.” But even before the policy provoked global security concerns, this ambitious industrial policy reflected China’s own sense of insecurity vis-à-vis its domestic economy and position in global supply chains. MiC2025 was conceptualized several years earlier in the aftermath of the global financial crisis and the Snowden revelations. In the spirit of “supporting national economic and social development and maintaining national security,” in June 2014 the PRC State Council released a set of guidelines on integrated circuits, calling them a “strategic technology.” The guidelines stressed China’s “huge gap” with leading countries and emphasized it was “difficult to achieve national industry core competency and to enforce information security.”

One channel Beijing identified for upgrading domestic technological capabilities was the establishment of multiple “professionally managed” private equity funds to invest on behalf of the state. In 2013, the Ministry of Industry and Information Technology piloted the model by selecting two private firms as general partners and fund managers. This model was extended to MiC2025 more broadly in 2015. Industrial policy and even innovation policy was not new, but obfuscation of state and private boundaries was, as was the creation of legal and political

46 Ibid.  
foundations for the party-state’s emboldened and more security-focused role. The permeation of state security goals into all kinds of organizations, a hallmark of party-state capitalism, was interpreted abroad as the coordination of Chinese society in an offensive drive to dominate and weaponize important supply chains.

**Party-State Capitalism**

“Securitization” of (or application of a security logic to) state economic intervention has generated a pronounced change in China’s model of political economy that we call “party-state capitalism.” Party-state capitalism contains new features and emphases undergirded by an extreme focus on maintaining the party’s monopoly on political power. These novel features build on structural elements of China’s state and economy, but have assumed much greater political importance, with profound impacts on firms. Most notably, these trends have obfuscated the conventional distinction between the state and firms, and between state-owned and private capital. Confusion and suspicion about these blurred lines have fueled intense backlash against Chinese firms operating abroad, thereby deepening Beijing’s sense of insecurity. China’s party-state capitalism differs from state capitalism, as practiced in China and elsewhere, in two main ways: 1) expansion of the party-state’s presence in firms through new corporate governance practices and financial instruments; and 2) demands for political fealty of firms and their connected individuals.

**Corporate Governance and the Party-State**

First, party-state capitalism manages China’s economy not only via the classic state capitalist tools of state ownership and market interventions, but also by new modes of control designed to embed the party-state more deeply into the country’s financial and economic system. The most direct channel for increasing party control of firms is through building party cells inside enterprises, including private and even foreign firms. The presence of party cells in private organizations in itself is not new, as even early CCP constitutions specified that any unit with more than three party members should have a party cell. In practice, this rule was lightly enforced. Xi has upgraded the role of party cells, and party building in firms has become a priority, consistent with his 19th Party Congress declaration in 2017 that the “Party exercises

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50 Gilpin’s classic statement on the international politics of investment identified three dominant “ideologies” of political economy – liberalism, Marxism and mercantilism. While party-state capitalism contains elements of all three, it is closest to mercantilism, insofar as both concepts highlight national security and the ideology of economic nationalism. However, as shown below, the tools of party-state capitalism bore much deeper into the domestic economic system than envisioned in Gilpin’s mercantilist ideology. Robert Gilpin and Jean M. Gilpin, *The Political Economy of International Relations* (Princeton, N.J.: Princeton University Press, 1987).


leadership over all areas in every part of the country.”

Since then, observers have noted rapid establishment of party organizations in private firms and joint ventures. The party reported that 1.88 million non-state firms – 73 percent – had established party cells by 2018. Firm-level party branch construction within private companies has led owners to express anxiety that these cells will intervene in firm management.

Party-state influence in China’s economy has also deepened through the deployment of new financial instruments, especially through investment of state-controlled capital well beyond state-owned firms. “Financialization” of the state’s role in managing SOEs is well-documented. The role of state capital outside majority ownership is a less understood development, but appears politically consequential. Most important has been the establishment of “state-owned capital investment companies” that invest in private enterprises to advance industrial policy goals and provide capital to firms with “strong growth potential.” These shareholding firms typically purchase on equity markets small minority stakes (generally less than 3 percent) in a listed private firm.

This new state-directed financial instrument took on unforeseen importance during the stock market crisis of summer 2015. In response to dramatic stock sell-offs that erased gains of the prior year, the China Securities Regulatory Commission convened a “National Team” of state shareholding funds to purchase over 1.3 trillion RMB of stocks on the Shenzhen and Shanghai exchanges. These funds eventually came to hold shares in half of all listed firms.


58 PRC State Council, “Zhonggong zhongyang guanyu quanmian shenhua gaige ruogan zhongda wenti de jue ding” [“CCP Central Committee Decision on Several Major Issue of Deepening Reforms”], November 15, 2013.

financial intervention was not about allocating capital toward productivity, efficiency and other economic ends, but rather, about risk management and economic stability maintenance, components of the party’s narrative about political control. The CCP has also introduced “special management shares” to monitor media and technology companies given their strategic and political importance. Special management shares are a class of equity with more weighted voting rights or special governance power per share. The first use of this system occurred in 2016 when the People’s Daily acquired one percent of a Beijing-based internet company and named a “special director” to the board with veto power over content.

Another new policy instrument related to state shareholding is the promotion of “mixed ownership,” defined as “crossholding by, and mutual fusion among state-owned capital, collective capital, and non-public capital.” Mixed-ownership enterprises (MOEs) now dominate the landscape of publicly traded companies. By March 2020, 41.6% of SOE group holding companies and 62.7% of their subsidiaries were classified as “mixed ownership,” i.e., having private shareholders.

POLITICAL FEALTY
The second key manifestation of party-state capitalism is expectation of political fealty by firms and their connected individuals. The CCP has recently targeted several high-profile private sector capitalists. In 2020 real estate magnate Ren Zhiqiang was sentenced to eighteen years in prison for “corruption” after criticizing China’s handling of COVID-19 and calling Xi Jinping “a clown.” Even Alibaba’s founder and Ant Financial chairman Jack Ma (Ma Yun), who once seemed irreproachable as an e-commerce pioneer and acknowledged CCP member, has faced trouble. Ant Financial’s initial public offering was dramatically halted just days before its launch, in part reflecting Xi’s displeasure at Ma’s publicized critique of securities regulators for holding outmoded views – which he said represented a “pawnshop mentality” – of bank

Other high-profile entrepreneurs have been targeted in a manner suggesting scrutiny of
their political loyalty.

The party’s demands that corporations toe its ideological line has extended to
multinational firms operating in China or otherwise subject to its market power. While
governments have the authority to regulate foreign businesses within their borders, the CCP has
also punished firms for perceived infractions, and spurred nationalist sentiment among Chinese
consumers. Meanwhile, a growing number of major brands and organizations have been
pressured to express contrition for missteps, primarily relating to how Hong Kong, Taiwan, and
Tibet are portrayed in their advertisements, websites, or social media, or for critiquing human
rights issues in Xinjiang. (Appendix A provides a list of multinationals that have been pressured
to apologize for their “political errors.”)

In addition to publicized solicitation of formal apologies by foreign capital, businesses
with significant stakes in the China market have changed their discourse and behavior, whether
due to direct pressure or self-censorship. When protests erupted in Hong Kong against a
proposed extradition bill with China in 2019, Cathay Pacific Airlines suspended staff who
participated in or expressed social media support for the demonstrations, followed by its CEO’s
resignation. When China introduced a National Security Law for Hong Kong the following
year, nearly all of the territory’s tycoons and international business leaders signed a statement
organized by the party’s United Front Work Department supporting the law—before its text was
even released. Political correctness on the part of foreign capital has become a condition of
access to China’s market under party-state capitalism.

External Backlash Against Chinese Firms: Security Competition Realized


68 Lucas Niewenhuis, “All the International Brands that have Apologized to China,” SupChina, October 26, 2019, https://signal.supchina.com/all-the-international-brands-that-have-apologized-to-china/.

69 Jamie Freed, “As Protests Wrack Hong Kong, China Watchdog has Cathay Staff ‘Walking on Eggshells,’” Reuters, October 3, 2019.

Evolving perceptions of China’s leaders led to the securitization of China’s economy and the accompanying emergence of party-state capitalism. These changes create great confusion and fear overseas about the nature of China’s political economy, and particularly about the party’s expanded presence in economic matters and expectations for political fealty. Murky boundaries between state-owned and private enterprises and the fact that large private companies have relatively few protections from increasingly aggressive state intervention suggests they are not as autonomous as one might expect based on ownership structure. Even firms claiming to be purely private may be politically well-connected. Once businesses reach a significant scale, they have accumulated myriad relationships with various bureaucracies, which connotes a degree of mutual dependence and vulnerability. The blurred distinction between “political” and “commercial” motives of firms has also fueled the perception that business interests are aligned with those of China’s party-state.71 Regardless of whether such fusion exists in particular cases, the ambiguity has produced tremendous uncertainty about China’s intentions abroad, and triggered security competition between China and other states, particularly the U.S. and its allies.

In the security dilemma literature, scholars have identified several mechanisms by which one state’s attempted increase in security, or increased capabilities, reduces the security of other states. Newly acquired capabilities can create confusion about offense and defense and increase uncertainty about intentions, giving rise to fear that a state is amassing capabilities to attack or wield against other states.72 The uncertainty about where China’s state or military end and firms begin has led other states to fear that China has the ability and/or intention to use firms, supply chain dominance, or economic dependence as a weapon against potential rivals. This is a major change from views of other nations in the 1990s and even later that China might be “pacified by globalization”73 or “playing our game.”74 The changes we describe as party-state capitalism, to the contrary, were perceived by other states not only as evidence China did not intend to “play by the rules of globalization,” but also that it intended to weaponize its firms and economic clout, thereby reducing the security of other states.

Economic interdependence with China has thus become a national security concern in many OECD countries. We identify three arenas in which backlash is observable. First, several countries have altered institutional processes for reviewing inward foreign investment from China. Second, large Chinese firms have been the subject of punitive measures as countries increasingly associate national champion firms with the party-state’s strategic interests. Third, at the domestic and transnational levels, novel institutions, such as the Department of Justice (DOJ)’s China Initiative and the EU-US Trade and Technology Council, have been established

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72 Jervis, Perception and Misperception.
to manage unique security threats perceived to be associated with China’s political economic model.

Before discussing economic backlash as security competition between China and other states, we acknowledge that not all economic contestation follows a security dilemma logic. Instead, some conflict between China and other countries, including conflict over Chinese firms, follows a purer logic of economic competition or trade conflict. Indeed, military allies may engage in trade disputes, and most trade disputes fall outside the realm of security competition. This remains true for China and the U.S. For example, the 2020 Phase I trade deal between the U.S. and China showed that cooperation was possible (albeit briefly) in part because security interests were not involved. The U.S., among other countries, has longstanding complaints about China’s treatment of foreign firms, technology transfer and intellectual property practices, and preference for state-owned firms. The measures discussed below go beyond conflict over economic practices precisely because they involve security concerns—and they emerged after the solidification of party-state capitalism. Further, Chinese telecom firm ZTE’s violation of U.S. sanctions on Iran ended with an agreement by which ZTE was allowed to access U.S. markets after paying a fine and under conditions of U.S. monitoring. Later, as we state below, ZTE was subject to sanctions and exclusions, but only after security interests regarding Chinese 5G vendors came to the fore. Our argument is not about general economic competition involving China; rather, we aim to explain specific dynamics of the backlash against China in terms of security dilemmas and security competition.

Scrutiny of Chinese FDI
Increased scrutiny of Chinese investment by recipient countries is a major arena in which we observe backlash spurred by party-state capitalism. In most cases, tightened review procedures reflect concerns over hazy ownership and the motives of investing Chinese firms. Backlash has, in turn, constrained China’s efforts to gain more economic security. This cycle of insecurity and securitization by China, and backlash by other governments, is exemplified in China’s efforts to bolster the security of its domestic semiconductor supply chain through strategic external investments. While Chinese firms are competitive in the manufacturing, outsourced assembly, and testing segments of the semiconductor supply chain, key Chinese industries rely on chips

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75 Economic conflict between the U.S. and Japan in the 1980s and early 1990s is instructive. The two countries were military allies, but fear of Japan overtaking the U.S. in critical industries generated pressure to restrict Japanese FDI in the U.S., contributing to the Exxon-Florio amendment in 1988 that institutionalized CFIUS review. Initially, some legislators wanted to require review for acquisitions that affected “national security” or “essential commerce,” the latter representative of backlash against Japanese FDI. Ultimately, “essential commerce” was deemed too broad and excluded from CFIUS purview. Therefore, while Japan’s rising economic power generated political backlash, it did not yield institutional backlash in part because it was not defined as a security concern. See Edward Graham and David Marchick, *U.S. National Security and Foreign Direct Investment* (Washington, DC: Institute for International Economics, 2006), pp. 33-53.


designed globally. As early as 2013, Beijing directed state and private funds to Chinese firms, encouraging them to acquire foreign technology, which they reasoned to be faster than catching up through domestic innovation.  

Initial acquisitions were successful, especially before major trade and investment partners were well-acquainted with MiC2025, and before new laws and policies entangled China’s security and economic efforts. In March 2015, a consortium of Chinese local government funds announced their intention to acquire Integrated Silicon Solution, Inc. (NASDAQ-ISSI), a specialty memory chip designer. The $640 million cash offer triggered competitive bidding, but was won by the Chinese consortium and approved by ISSI shareholders. The proposed sale prompted Representative Dana Rohrabacher (R-Huntington Beach) to write a letter to Treasury Secretary Jack Lew warning that Chinese acquisitions had the potential of “gutting” U.S. semiconductor capability. Nonetheless, CFIUS approved the deal in November, around the time it approved the $1.9 billion cash purchase by another Chinese semiconductor fund consortium of OmniVision (NASDAQ:OVTI), a digital imaging solutions developer.

The tide turned quickly, however, due to the U.S. and other government’s heightened concerns over China’s new economic practices. This backlash against China’s acquisition efforts in semiconductors pre-dated Trump’s presidency and onset of generalized Sino-U.S. trade conflict. By the end of 2016, actors inside and outside the U.S. were already voicing security concerns about blurred ownership lines and China’s economic-security nexus. A White House report during the last month of Obama’s presidency, for example, stated that the U.S. should “calibrate its application of national-security controls in response to Chinese industrial policy aimed at undermining U.S. security.”

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82 Executive Office of the President and President’s Council of Advisors on Science and Technology, “Report to the President: Ensuring Long-Term U.S. Leadership in Semiconductors,” https://obamawhitehouse.archives.gov/sites/default/files/microsites/ostp/PCAST/semiconductors_pcast_presentation
security dilemma dynamic: policies adopted in China to buttress its own security were interpreted as new capabilities and intentions targeted against the U.S.

In December 2015, U.S. and European officials became sufficiently alarmed by the use of industrial policy and the web of relations between potential purchasers of German chip machine supplier Aixtron, to intervene.83 One year later, Obama blocked the proposed acquisition of the U.S. business of Aixtron, the third time any president had done so since CFIUS’s establishment in 1975.84 The Department of Treasury rationalized that the bidder was “owned by investors in China some of whom have Chinese government ownership,” noting the deal would have been funded by “a Chinese government-supported industrial investment fund established to promote the development of China’s integrated circuit industry.”85 Blurred lines between the state and firms, coupled with a seemingly coordinated and security-motivated industrial policy, contributed directly towards blocking Chinese acquisitions.

Ultimately, policymakers in the U.S. and beyond decided that extant institutions like CFIUS and export control regimes were insufficient to address the perceived threat of China’s party-state capitalism. In summer 2018, a bi-partisan bill (the Foreign Investment Risk Review Modernization Act, FIRRMA) overhauled CFIUS. While CFIUS procedure previously required review only when a foreign investor pursued a controlling stake, the new process expanded review to any stake in companies “with substantial business in the U.S.” when they are in “emerging technologies” or “critical infrastructure.”86 Senator John Cornyn, one of the FIRRMA bill’s co-sponsors argued, [T]he context for this legislation is important and relatively straightforward, and it’s China...China has been able to exploit minority-position investments in early-stage technology companies...And there is no real difference between a Chinese state-owned enterprise and a

86 Specifically, this included non-controlling investments in a U.S. business that afford a foreign person 1) Material non-public technical information,” meaning “information that is not available in the public domain, and is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies,” 2) membership or observer rights on the board of directors or equivalent, or 3) any involvement, other than through voting of shares, in substantive decision-making regarding the use, development, acquisition, or release of critical technologies.” Federal Register Vol. 83, No. 197, Oct. 11, 2018, https://home.treasury.gov/system/files/206/FR-2018-22187_1786944.pdf
‘private’ Chinese firm in terms of the national security risks that exist when a U.S. company partners with one.87

Since 2018, Chinese investment in the U.S. has fallen, and its investment in the technology sector is near zero. The rise and fall of Chinese investments in the U.S. semiconductor sector exemplifies the cycle by which China’s party-state capitalism mobilizes to address a security concern, and in doing so, generates self-defeating backlash.

The U.S. is not alone. In the late 2010s, many OECD countries passed new legislation to establish or strengthen investment review processes in response to changes in China’s political economy.88 The U.K. issued a Green paper in 2017 calling for investment review and in 2018, France, Germany, and Italy initiated discussions of an EU-wide investment screening process.89 In semiconductors, Taiwan and South Korea, two key hubs for ICT global supply chains, took steps to prohibit or restrict Chinese acquisitions and prevent transfer of intellectual property and engineering talent to China.90 In 2019, the Australian Foreign Investment Review Board (FIRB) announced intent to increase scrutiny of Chinese private companies looking to buy Australian assets because there “is no such thing as a private company in China.”91

As the external economic environment tightened for China, domestic commitment to self-reliance and security concerns over economic capabilities intensified. Shortly after CFIUS’s overhaul, and as Chinese investment in OECD countries was plummeting due to political concerns, Xi Jinping remarked that China must rely on itself if rising unilateralism and protectionism obstructs access to leading technologies internationally, saying that self-reliance “is not a bad thing.”92

SUSPICION OF LARGE CHINESE FIRMS

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Backlash to party-state capitalism has engendered harsh global treatment of large Chinese firms. National and supranational actors increasingly treat Chinese firms in many sectors, whether state-owned or not, as extensions of the party-state. These international actors express concern that such firms could compromise national security and/or foster dependence on China. Over the last several years, the U.S. and other OECD countries have taken extraordinary steps to manage the perceived threat of China’s “national champions,” making them the targets of coordinated containment efforts.

The global fight over 5G has taken center stage in Sino-US competition and deeply affected third party countries. ZTE’s state-owned status and Huawei’s murky ownership have long attracted the suspicions of American lawmakers. A 2012 House Intelligence Committee Report criticized both companies for failing to clarify their relationships with the CCP and warned that they posed threats of “economic and foreign espionage by a foreign nation-state already known to be a major perpetrator of cyber espionage.”93 The report recommended that the U.S. government and private sector exclude Chinese vendors from their systems, yet it would be almost seven years before the 2018 National Defense Authorization Act (NDAA) prohibited federal agencies from procuring products/services from Huawei or ZTE. Meanwhile, Huawei equipment was already widely used in rural networks in the U.S. and the company had extensive U.S.-based R&D centers, including partnerships with Stanford, MIT, and UC-Berkeley.94

Apprehensions mounted over Huawei’s acknowledged theft of intellectual property, its publicly-traceable reliance on subsidies from the Chinese government, and alleged aggressive practices and corporate espionage.95 The company’s behavior caused many, including those who generally supported economic engagement with China, to support sanctions against and/or a Section 301 investigation of Huawei.96

By 2018, U.S. efforts to limit international expansion of Chinese telecom firms became increasingly urgent. The detention in Canada of Huawei’s Chief Financial Officer Meng Wanzhou, at the DOJ’s request, was followed in May 2019 by the Trump administration’s executive order to place Huawei and its affiliates on the U.S. Department of Commerce’s Bureau of Industry and Security (BIS) “unreliable entity” list. As Chinese telecom firms were subjected to unprecedented export controls, the U.S. State Department launched a global campaign against

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96 Interviews with former Commerce Department official (December 2018) and former USTR advisor (October 2017). Section 301 of the Trade Act of 1974 enables the Office of the United States Trade Representative to investigate and take action to defend the U.S. from unfair foreign trade practices.
China over 5G. Allies in Europe, Asia, Latin America and beyond were exhorted to join the U.S.-led “Clean Network” or risk losing U.S. investment, aid, or intelligence sharing.

Why did the U.S. initially open doors, albeit tepidly, to Chinese telecom firms and then embark on a global campaign to constrain and cripple them? We argue that the change in China’s domestic political economic model contributed to this acceleration. While there had always been doubts about Huawei’s independence from the CCP and China’s military, claims that the company could be independent or exclusively commercially-minded seemed increasingly implausible. The U.S. government’s view of Chinese technology firms, and economic interdependence with China in general, became focused on security in reaction to the CCP’s domestic securitization and model of party-state capitalism.

The Trump administration’s policies toward Chinese tech firms—initiated under Obama and then largely continued under President Biden—were based on concerns about the “pervasive nature of CCP power in China’s domestic economic and legal system,” such that the “party-state operates with a broad conception of national security and has tightened its grip on companies and citizens alike.”97 To be sure, the “omni-use” nature of technologies mattered, but it was the perception of China’s domestic political economy that changed over time, narrowing the space for cooperation and tolerance in host countries and trade partners.

The Pompeo State Department’s global Clean Network initiative, which began with 5G and expanded to a wide swath of tech sectors (cloud computing, undersea cables, software applications, data, minerals, infrastructure, and more), illustrates the importance of China’s political economic system in generating broad backlash. Many OECD countries, including the U.K., Germany, and France, initially allowed Huawei to bid for 5G contracts and pursued technical solutions to mitigate risk. The U.K., for example, established the Huawei Cyber Security Evaluation Centre under the auspices of the National Cyber Security Centre (NCSC) as early as 2010.98 Over the course of 2019-20, however, many OECD governments and some in developing countries decided to exclude Huawei from networks, irrespective of its technical assurances or solutions, over concerns it was a Chinese company that could not guarantee its independence from the CCP. A German policy report concluded: “While there is also little reason to believe that the company has a particular interest in serving political purposes, Huawei has not only profited from party-state support, but is operating in a specific political, legal and economic environment that makes it impossible for the company to be fully independent.”99 Wariness about China’s political economy extended beyond the risk of “backdoors” or Huawei’s compelled participation in PRC intelligence work to encompass the risk that excessive


dependence on Chinese technology would translate into political leverage. This perceived threat motivated the EU’s “Toolbox for 5G Security,” which requires member states to “ensure that each operator has an appropriate multi-vendor strategy to avoid or limit any major dependency on a single supplier and avoid dependency on suppliers considered to be high risk.”

Australia likewise banned Chinese telecom vendors in 2018 due to the belief that these firms were “likely to be subject to extrajudicial directions from a foreign government” and therefore posed a security risk.

New attempts to manage the perceived political risks of large firms are not confined to technology. Amidst a rise in investment following the global financial crisis, the European Commission sought a means review of Chinese SOE investments, but various individual SOE assets in the EU were too small to trigger the review threshold. In 2016, however, the Commission issued a landmark decision to treat all Chinese SOEs in a single sector as one entity, thereby enabling the Commission to adjudicate any given SOE’s deals with any EU entity. The decision represented European policymakers’ deployment of competition policy to address the perceived problems of state objectives affecting commercial enterprises in China’s model of party-state capitalism.

**Institutional Reorganization and Innovation**

We have discussed how extant institutions in OECD countries have been overhauled or strengthened, and observed attempts at building new national and transnational institutions to manage perceived threats posed by Chinese businesses. In each of these situations, policymakers argued for new tools and policies due to the blending of state and commercial, or social, interests in China. The proposed solutions envision dramatic changes in the nature of Western political economy and, in some cases, spur controversial and intrusive behaviors into both the economy and U.S. society.

For example, we observe mounting efforts to limit outbound investment to China, especially in the U.S. CFIUS was designed to ensure that foreign firms investing in the U.S. do not compromise national security interests. But with escalating concerns about forced technology transfer and the prospect of American capital supporting party-state goals, policymakers have begun to imagine institutions or rules that restrict the freedom of U.S. firms to make decisions about outbound investments. Indeed, a first iteration of the FIRRMA bill would have expanded CFIUS’s purview to review every external investment of a U.S. business. In the end, FIRRMA did not contain this provision, but the idea of an institution to review outbound investment remains. Questioning at a 2021 hearing of the U.S. China Economic and Security Review


102 Zhang, *Chinese Anti-Trust Exceptionalism*, pp. 119-162.
Commission expressly considered the features of an “outbound CFIUS.” A wave of recent executive orders has tightened restrictions on U.S. capital investment in Chinese firms allegedly linked to the People’s Liberation Army. Former President Trump issued such an executive order in November 2020, and in June 2021, President Biden expanded the limits to include “use of Chinese surveillance technology outside the PRC, as well as the development or use of Chinese surveillance technology to facilitate repression or serious human rights abuses.” Efforts in the U.S. Congress to restrict outbound foreign investment to China continued unabated into 2022.

Established in November 2018, the DOJ’s “China Initiative” provides a controversial example of an expansive response designed in part to address the uniqueness of China’s model and the blurring of state and society. The initiative, the first that named a specific country, was premised on the idea that a variety of activities emanating from the PRC, including economic espionage, IP theft, influence on academic campuses, and more, pose a significant national security threat to the U.S. and require a muscular response. FBI Director Christopher Wray reasoned, China from a counterintelligence perspective represents the broadest, most challenging threat we face at this time… because with them it’s a whole of state effort. It is economic espionage as well as traditional espionage; it is nontraditional collectors as well as traditional intelligence operatives; it’s human sources as well as cyber means.


Among its multiple targets, the China Initiative addressed growing suspicion that scientific and academic exchanges are a core channel for IP theft, espionage and other security risks. As the US Attorney for the District of Massachusetts Andrew Lelling contended in a statement, “If you are collaborating with any Chinese entity, whether it’s a university or a business, you are giving that technology to the Chinese government.” The intense scrutiny directed at Chinese nationals and Chinese-Americans resulted in multiple cases of investigative overreach and racial profiling, which provides Beijing with further evidence of anti-China sentiment in the US. In February, 2022, after a months-long review and few results to show, the DOJ formally ended the China Initiative.

An altogether different set of national reactions to China’s model is less about constraining China and more about emulating its industrial policies and encouraging public-private partnerships. MiC2025 was modelled in part on Germany’s “Industry 4.0” plan. Reactions by policy-makers in the U.S., even among Republicans typically critical of statist economic intervention, include calls for “catalytic” investments in domestic technology sectors, extensive government procurement to create markets for novel technologies, and massive state investment in frontier sectors. In July, 2022, a $52 million bipartisan “CHIPS Act” passed the U.S. Senate, with the goal of encouraging semiconductor companies to boost production of chips in the U.S. Although some of the architects of these new industrial policies are uneasy about them, they argue that changes are necessary to address China’s unique political economy.

One State Department advisor remarked: “We’re being backed into a more intrusive set of
government policies. But we don’t have a choice if we’re going to deal with the commercial threat posed by China’s national champions.”

At the levels of U.S. foreign policy and international regulation, concerns have shifted from managing unfair competition with “China, Inc.” to confronting party-state capitalism, in which economic interdependence is interpreted to pose a security threat in addition to an economic one. U.S. officials and trade attorneys have long considered WTO rules, including those designed to restrict advantages SOEs might gain from access to state funds, to be inadequate for addressing challenges posed by China. Recent thinking about how to manage the perceived ill effects of party-state capitalism has occurred largely outside of international institutions such as the WTO, and in a style more akin to military alliances. A prime example is the Clean Network initiative, which took the shape of a transnational network partly to “provide a security blanket against China’s retaliation,” as its architect explained.

At the extreme, China’s blending of political imperatives and economic interdependence has prompted calls for a “new kind of alliance—like NATO, but for economic rather than military threats.” Some view China’s threats of retaliation and economic boycotts of countries that challenge its political views or discriminate against its firms as a problem that can only be addressed collectively through joint imposition of tariffs, provision of capital and strategic resources for countries punished by China, and other forms of “collective economic defense.”

Milder but still consequential forms of multinational institutional innovation involve increased attention to alliance-focused coordination on technology use and standards, data use and privacy, and supply chain resilience. Established in June 2021, the US-EU Trade and Technology Council is, in the words of Biden’s national security advisor, intended to align “our approaches to trade and technology so that democracies and not anyone else, not China or other autocracies, are writing the rules for trade and technology for the 21st century.” The Council will initially prioritize coordinating standards on AI, quantum computing, and bio-technologies, all target industries for China’s industrial policy and blurred ownership mechanisms.

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114 Such concerns were the predominant reasons for the Sino-US trade war that began in 2018. Even though national security was at times invoked as the rationale, such as for iron and steel, the measures, reflecting what was legally most expedient in U.S. law, stuck to more standard trade remedies such as tariffs. On “China Inc.,” see Mark Wu, “The ‘China, Inc.’ Challenge to Global Trade Governance,” Harvard International Law Journal, Vol. 57 (May 13, 2016), Harvard Public Law Working Paper No. 16-35, https://ssrn.com/abstract=2779781.

115 Wu, “The ‘China Inc.’ Challenge.”

116 Keith Krach, U.S. Undersecretary for Economic Affairs in the Trump administration, said, “The elephant in the room was always the CCP’s bullying. Countries and companies were terrified of its retaliation. However, the key to beating all bullies is to confront them head-on. …. And he really backs down if you have your friends by your side. The key to defeating China Inc. lies in the power of assembling a network of trusted partners to serve as a security blanket against China’s retaliation.” Interview with author, January 27, 2021.


Before concluding, we consider how our account of China’s domestic changes and ensuing international backlash may be distinguished from other explanations of conflict involving China, especially with the U.S. and its allies. One explanation for U.S.-China economic contestation might attribute their rivalry to the structure of the international system. Realist views focus on tensions inherent in China’s emergence as a global superpower and potential to challenge American hegemony. Realists therefore expect that the U.S. and its allies would seek to contain China’s rise and that security dilemma dynamics would materialize.\footnote{Mearsheimer.} We do not see such an argument as inconsistent with our evidence and explanation, but classical realism does not predict conflict primarily in the economic realm, nor does it encompass non-state actors such as firms. Unlike a liberal institutionalist view, these approaches do not regard international regimes as sufficient to ameliorate forces of mutual distrust and suspicion, nor do they predict that economic interactions would lead to security competition.


For example, in debates about export controls, many believe that the national security apparatus has been at odds with American business interests. The head of the U.S. semiconductor industry group expressed concern about the negative impact of export controls on U.S. firms, citing that China “accounted for about one-third of the industry’s revenue, and that it would be ‘disastrous’ for semiconductor companies to not have access to such a huge and growing market.” In another example, a commissioner on the U.S.-China Congressional Commission and advocate of “decoupling” stated:

\begin{quote}
The industry viewpoint has been the Commerce viewpoint since the fall of the Soviet Union, and they’re not able to make the adjustment that the work has changed …The industry capture is not, in my view, industry saying, ‘Hey, meet me at the Jefferson Memorial and I have a suitcase of money for you.’ It’s that these guys have been trained for 30 years to think that exports are good for America and that’s that… So surprise, they don’t want tighter export controls.\footnote{Ana Swanson. “The Agency at the Center of America’s Tech Fight with China,” \textit{The New York Times}. March 26, 2021. \url{https://www.nytimes.com/2021/03/26/business/economy/commerce-department-technology-china.html}.} \end{quote}
Hearings on FIRRMA featured representatives from the financial sector, especially venture capital, expressing sharp opposition to enhanced review, as well as arguments from advocates of review on outbound investments that U.S. firms cannot be trusted not to transfer technology to China.\(^{123}\)

To be sure, the interests of firms related to China vary by sector, geography, and so forth. On balance, however, the U.S. business community has reacted with alarm and opposition to calls for national security-based decoupling. The American Chamber of Commerce’s China 2021 Policy Priorities document states,

> We remain opposed to any effort at outright decoupling of the US-China relationship. The costs of decoupling from losing trade and foreign investment benefits for both countries would be significant and unlikely to generate clear winners. We respect the legitimate needs of both countries to define and protect their national security and law enforcement interests and urge them to do so in ways that leave space for commercially-focused engagement to take place and in close consultation with the business community.\(^ {124}\)

The geographic scope and institutional diversity of backlash against China and Chinese firms is better explained in terms of security dilemma dynamics than manifestations of vested interests.

**Conclusion**

Driven by the leadership’s amplified perceptions of threats to economic and national security, China’s shift from a classic form of state capitalism focused mainly on growth to “party-state capitalism” was an unwelcome development for western policymakers. Rather than pursuing further market liberalization, as some had hoped, China has instead intensified state control over the economy and society, with a much more pronounced role for the CCP’s political priorities domestically and abroad. Along with Chinese firms’ growing overseas presence, this change in China’s political economy has stoked external suspicion of Beijing’s motives and behaviors. While some commentators believe that the west has finally “woken up” to the CCP’s long-term plans, we view this shift as neither inevitable nor based on a blueprint for global political dominance.\(^ {125}\) We have argued that China’s political economic model evolved in a process that began before Xi’s assumption of power and sharpened under his leadership. The underlying mechanism was the regime’s intensified perception of domestic and international threats.

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The emergence of party-state capitalism in China has also produced significant tension domestically as the primacy of politics affects government-business relations. Reflecting on the business sector’s relationship to the state, the CEO of search engine Sogou observes:

We’re entering an era in which we’ll be fused together… If you think clearly about this, you really can resonate together with the state. You can receive massive support. But if it’s your nature to want to go your own way, to think that your interests differ from what the state is advocating, then you’ll probably find that things are painful, more painful than in the past.126

Things have indeed been more painful for prominent entrepreneurs who have famously lost control over their firms or their freedoms for running afoul of the CCP. China’s unprecedentedly rapid growth for most of the reform era was driven by private firms whose interests did not threaten the regime, and sometimes even spurred the regime to adapt to them.127 It remains to be seen whether those innovative and productive practices will continue apace under a new political-economic system in which firms and individuals face greater, even existential, risks.

Global backlash has intensified and accelerated. We show that much of this backlash has been generated by, and subsequently directed against, the blurring of state interests and commercial endeavors. National governments in OECD countries are highly uncertain about – and threatened by – the inability to parse the boundary between the state and firms, whether state-owned or private. This confusion and risk aversion, reinforced by those who seek to gain from politicizing China’s international presence, has led to the securitization of cross-border trade and investment flows with China. Thus, whereas the CCP embraced party-state capitalism to make the regime more secure domestically and internationally, instead it has fomented increasing isolation, suspicion, and exclusion, which pose limits on China’s global ambitions. The result has accelerated China’s quest for self-reliance in crucial strategic goods and fusion of state and societal interests. Taken together, these dynamics bear the spiraling hallmarks of a classic security dilemma, but one located in the economic realm.

We have also documented rapid institutional change within and across advanced industrial democracies as they react to China’s transformation under complex interdependence. We have shown how, at the domestic and transnational levels, the formal and informal rules of capitalism have changed as national governments and political actors endeavor to manage perceived threats presented by China’s unique blend of state and economy, “party-state capitalism.” This change is illustrated most strikingly in the U.S., a country with historically very low barriers to capital flows, via bi-partisan initiatives to control not only incoming capital but also the outflow of capital. Collectively, the backlash and institutional changes documented here could constitute a lasting shift for the international order in terms of economic openness and interdependence. A good deal of scholarship addresses whether China presents a challenge to the “rules-based international order,” or more precisely, the many international orders in which China is engaged.

Several scholars have argued that China is unlikely to challenge open trade and international financial orders. However, they have overlooked how other countries’ reactions to China’s unique global economic presence may affect interdependence. Core aspects of the international order characterized by principles of free trade and open borders have already been compromised, not principally by China’s own intentions and efforts, but rather by the actions of other countries in response to its model.

China’s economic rise and its domestic economic transformation have had an unsettling effect on global capitalism and the strategies of national political economies. A growing literature in macroeconomics examines the “China shock,” referring to how China’s entry into global markets has transformed labor markets and political preferences throughout the world. The empirical trends documented here suggest a research agenda that examines a different, political form of a China shock, and one best studied by political scientists: how global and domestic actors have initiated or reshaped agendas and preferences in light of the unique challenges presented by China’s political economic model. Like other critical junctures or disruptions in the global political economy—such as the oil crises of the early 1970s and the rise of knowledge economies in the 1990s—a “China shock” refracted through domestic electoral politics and social movements could upend long-held political commitments, and introduce novel responses that shape the political and economic gestalts of a new era.

### Appendix A. Multinationals Pressured by China to Apologize for “Political Errors”

<table>
<thead>
<tr>
<th>Company</th>
<th>Date of Apology</th>
<th>Political Error</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audi</td>
<td>3/15/17</td>
<td>Used map of China without Taiwan and parts of Tibet and Xinjiang in a presentation in Germany.</td>
</tr>
<tr>
<td>Muji</td>
<td>10/2017</td>
<td>Map in catalogue did not include Senkaku Islands.</td>
</tr>
<tr>
<td>Delta Air Lines</td>
<td>1/12/18</td>
<td>Listed Taiwan and Tibet as countries on website.</td>
</tr>
<tr>
<td>Zara</td>
<td>1/12/18</td>
<td>Listed Taiwan as a country on website.</td>
</tr>
<tr>
<td>Marriott Int'l</td>
<td>1/12/18</td>
<td>Listed Tibet, Hong Kong, and Taiwan as countries on customer survey.</td>
</tr>
<tr>
<td>Medtronic</td>
<td>1/15/18</td>
<td>Listed Republic of China (Taiwan) as country on website.</td>
</tr>
<tr>
<td>Mercedes-Benz</td>
<td>2/6/18</td>
<td>Quoted Dalai Lama on Instagram.</td>
</tr>
<tr>
<td>Gap, Inc.</td>
<td>5/14/18</td>
<td>T-shirt with map of China did not include Taiwan.</td>
</tr>
<tr>
<td>American Airlines</td>
<td>6/25/18</td>
<td>Listed Taipei under Taiwan as a country on website.</td>
</tr>
<tr>
<td>United Airlines</td>
<td>6/25/28</td>
<td>Listed Taiwan as country on website.</td>
</tr>
<tr>
<td>McDonalds</td>
<td>1/19/19</td>
<td>TV ad in Taiwan showed student ID with Taiwan as a country.</td>
</tr>
<tr>
<td>UBS</td>
<td>6/13/19</td>
<td>Economist Paul Donovan referred to a “Chinese pig” during audio briefing.</td>
</tr>
<tr>
<td>Versace</td>
<td>8/10/19</td>
<td>T-shirt with “Hong Kong” did not list “China” after it.</td>
</tr>
<tr>
<td>Givenchy</td>
<td>8/12/19</td>
<td>T-shirt with “Hong Kong” did not list “China” after it. “Taiwan” listed after “Taipei.”</td>
</tr>
<tr>
<td>ASICS</td>
<td>8/12/19</td>
<td>Listed Hong Kong and Taiwan as countries on website.</td>
</tr>
<tr>
<td>Coach</td>
<td>8/12/19</td>
<td>Listed Hong Kong and Taiwan as regions separate from China on website. T-shirt with “Hong Kong” without country following it, and Taiwan listed after “Taipei.”</td>
</tr>
<tr>
<td>Calvin Klein</td>
<td>8/13/19</td>
<td>Listed Hong Kong and Taiwan as separate countries or regions on website.</td>
</tr>
<tr>
<td>Valentino</td>
<td>8/13/19</td>
<td>Listed Hong Kong and Taiwan as separate regions on website.</td>
</tr>
<tr>
<td>Swarovski</td>
<td>8/13/19</td>
<td>Listed Hong Kong as country on website.</td>
</tr>
<tr>
<td>NBA</td>
<td>10/6/19</td>
<td>Houston Rockets General Manager Daryl Morey tweeted support for protestors in Hong Kong.</td>
</tr>
<tr>
<td>Tiffany &amp; Co.</td>
<td>10/7/19</td>
<td>Ad with model Sun Feifei covering one eye (Hong Kong protest reference).</td>
</tr>
<tr>
<td>Apple</td>
<td>10/9/19</td>
<td>Hosted app HKMapLive used by protesters in Hong Kong to track police.</td>
</tr>
<tr>
<td>Dior</td>
<td>10/17/19</td>
<td>Delivered presentation in China with map without Taiwan.</td>
</tr>
<tr>
<td>Burger King</td>
<td>3/20/20</td>
<td>Burger King Taiwan referred to “the Wuhan pneumonia” on social media.</td>
</tr>
<tr>
<td>HSBC</td>
<td>6/4/20</td>
<td>CEO did not immediately sign petition organized by CCP’s United Front Work Department supporting new National Security Law for Hong Kong.</td>
</tr>
<tr>
<td>Adidas, Burberry, H&amp;M, Lacoste, Nike, etc.</td>
<td>2021</td>
<td>Members of Coalition to End Forced Labour in the Uyghur Region boycotting cotton from Xinjiang.</td>
</tr>
<tr>
<td>Intel</td>
<td>12/23/21</td>
<td>Instructed suppliers not to procure from Xinjiang.</td>
</tr>
</tbody>
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