



# **26-15 China's Economic Security Growth Model and Implications for the US-China Security Dilemma**

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## **ABSTRACT**

Traditional conceptions of export- or domestic investment-led growth no longer appropriately capture the dynamics shaping the Chinese economy. Rather, China has adopted a model in which national security logic increasingly underpins economic policy. This paper first outlines the main components of this growth model: a dual circulation strategy for balancing between external and domestic demand, a domestic industrial strategy premised on self-reliant innovation, and a legal and regulatory toolkit to respond to perceived acts of economic coercion from abroad. It then identifies potential implementation challenges and tensions emerging from such a growth strategy, and discusses the ways these tensions might deepen the US-China security dilemma. The paper concludes with policy recommendations for mitigating these security dilemma risks, through unilateral and bilateral actions, some of which could be based on core principles in multilateral trade regimes.

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## I. INTRODUCTION

China has long had a conflicted relationship with globalization. While the country's extraordinary rise is often reduced to a single narrative about export-led manufacturing, such a view is too narrow.<sup>1</sup> Instead, China's economic expansion since the late 1970s has been powered by two internally competing logics: an export-led growth model, concentrated along the coast and focused on manufacturing; and a state-led investment model, centered more in the interior and premised on property and infrastructure development. Over the past few decades the massive Chinese economy has shifted its weight between these two growth models in relative terms. External shocks, from the 1997–98 Asian financial crisis to the 2008 global financial crisis, repeatedly triggered efforts in China to recalibrate between external and internal markets (Tan and Conran 2022).

Another shift has taken place in recent years. With the supply shocks brought about by the COVID-19 pandemic, as well as trade and technology frictions with the United States since 2016, it is no longer appropriate to describe China's growth model as based on either manufacturing exports or domestic debt/property development. China is now attempting to reanchor itself on an economic security growth model, where a national security logic increasingly drives economic policies. In this latest recalibration, the sources of uncertainty in the external environment are less about market volatility and instead found in the behavior of foreign governments and geopolitical uncertainty.

While China's turn toward economic security is in large part driven by a change in its external threat assessment since the imposition of US trade and technology restrictions against it, this turn follows on a change in American strategic assessment of relations with China. I do not delve into the reasons behind that change in US strategy, which have been discussed elsewhere (see Pearson, Rithmire, and Tsai 2022). By focusing on just one arm of the action-reaction cycle in US-China relations, this analysis aims

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1 See Koopman, Wang, and Wei (2012), and Lardy (2012) on the debate on the role of exports in driving China's economic growth.

to elucidate policy insights that can address the broader security dilemma in great power relations.<sup>2</sup>

This paper first outlines the key components of China's economic security growth model and briefly discusses how each component is playing out. It then discusses the tensions of balancing between economic development and national security, and highlights potential deviations from standard decision making that result from the shift to a security logic in economic governance. [Section IV](#) explains why the use of economic weapons might worsen the traditional security dilemma between states, and discusses the potential pathways through which this might occur. The [concluding section](#) provides some recommendations for mitigating escalatory dynamics between the United States and China.

## II. CHINA'S NEW ECONOMIC SECURITY GROWTH MODEL

The rise of a security logic in Chinese economic policies can be observed through changes in the country's high-level guidances. The 2015 National Security Law marked the formal introduction of a "comprehensive national security concept," which, for the first time, framed different forms of security—political, economic, military, cultural, and social—as interconnected and indivisible, and which treats economic security as "foundational" to national security. That said, these security concerns, which were internally focused, did not immediately change economic policy thinking, as seen by a comparison of the 2016 13<sup>th</sup> and 2021 14<sup>th</sup> Five-Year Plans. President Xi Jinping's speech on the 13th Five-Year Plan mentioned the term "security" six times, and only in passing. The overall agenda was instead focused on industrial upgrading, and security concerns were conveyed as a subordinate rather than equal goal or binding constraint (Xi 2015, Central Committee of the Communist Party of China 2015).

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2 The security logic underpinning the economic policies of both the US and China makes current geopolitical tensions different from those that beset US-Japan relations in the 1980s and 1990s. It also makes the spillovers to other countries different from those resulting from China's earlier growth focus on either exports or investment.

From 2018 onward, the United States' denial order against ZTE and subsequent entity listing of Huawei triggered a high-level reassessment of the underlying vulnerabilities posed by globalization broadly (Tan et al. 2025). This is manifested in Xi's explanation of the 14th Five-Year Plan, which reframed China's strategic approach to one where "security is a prerequisite for development, and development is a guarantee of security" and called for the party-state to "coordinate development and security" (Xi 2020). The 2021 plan elevated technological self-reliance and resilience to core national objectives, and in 2022 the Chinese Communist Party (CCP) introduced a formal shift in its external threat assessment at its 20<sup>th</sup> Party Congress. Xi's political report at the Congress revised the longstanding view that China was in a "period of strategic opportunity" and noted instead that the country "has entered a period of development in which strategic opportunities, risks and challenges are concurrent and uncertainties and unforeseen factors are rising" (International Department of the CCP 2022).

The incorporation of security thinking in China's economic doctrine was further demonstrated in the 20<sup>th</sup> Central Committee's Third Plenum resolution laying out the Party's medium-term guidance for the economy. This resolution mentions the term "security" 41 times; in contrast, the preceding Third Plenum resolution aimed at economic governance, released in 2013, mentioned the term 24 times (CCP Central Committee 2013, 2024).<sup>3</sup>

While the new governance approach that seeks to "coordinate development and security" has been spelled out only in broad strokes, there are three broad elements that arguably form the basis of China's economic security growth model. First, a dual circulation strategy seeks to place a relatively heavier weight on growth from domestic demand while diversifying trade relationships away from developed markets. This is motivated less by a desire to reduce China's exposure to the vagaries of global markets than to reduce the ability of foreign governments to damage China's economic strength by exploiting trade dependencies.

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3 The 2018 resolution mentions "security" only six times, but the session was not focused on economic governance (CCP Central Committee 2018).

Second, an industrial strategy aims at weaning the country off debt-based property growth and restructuring economic drivers toward high-tech industries and innovation. This component addresses both domestic and international security threats. Domestically, the reliance of local governments on property and infrastructure as a growth driver had led to excessive debt and hidden financial risks that threatened social and regime stability. Economic restructuring was therefore imperative. The renewed focus on innovation and technology is aimed at reducing the US ability to exploit vital dependencies that might impair China's civilian and military strength.

Third is a new legal and regulatory countercoercion toolkit that enables China to retaliate against what it sees as external acts of economic hostility. The toolkit includes measures that would make it illegal for firms and individuals to comply with various restrictions enacted by foreign governments, and would empower China to counteroffensively restrict the flows of goods, services, people, and technologies based on broad national security and development rationales.

Whether each element of this geoeconomic strategy will succeed is yet to be determined. The extent to which each component adds up to an economic model that delivers both growth and security is an even larger unanswered question. This section details the degree to which China has been able to implement its vision for “coordinat(ing) security and development,” and then [section III](#) turns to the tensions that may impede attainment of the country's economic security growth model.

## Dual Circulation

China's dual circulation strategy, part of what it sees as a “new development paradigm,” seeks to boost domestic demand to drive growth (domestic circulation) while continuing to engage in global value chains (external circulation) (NDRC 2022). The aim is, in Premier Li Qiang's words, to “leverage the inherent stability and long-term growth potential of domestic circulation to offset the uncertainties in the international market” (Cao 2025).

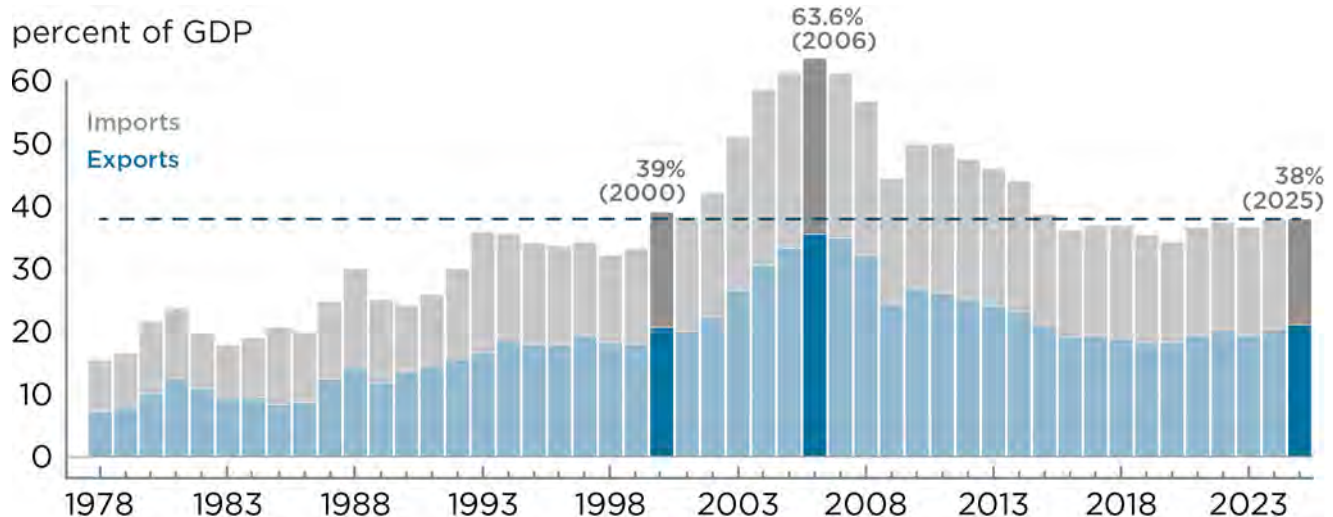
This hedge against external demand is not new, in the sense that previous shocks, from the Asian financial crisis to the global

financial crisis, have also led China to recalibrate. What is different is that the dual circulation strategy is prompted by uncertainties about the actions of foreign governments rather than uncertainties in foreign markets. This underscores the security logic that underpins China's current economic thinking.

China's trade share of GDP has been steadily declining since 2007, from a peak of almost 64 percent in 2006 to 38 percent in 2025, roughly the same as in 2000 before China joined the World Trade Organization (WTO). Its export share of GDP has followed the same pattern, declining from a peak of 35.5 percent in 2006 to 21.1 percent in 2025 (figure 1). Given these trends, China's dual circulation strategy is less about reducing absolute trade numbers and more about minimizing import dependencies that might create strategic vulnerabilities (State Council Information Office 2023, Xinhua 2025).

Figure 1

### China's goods trade to GDP ratio, 1978–2025



Source: [World Bank](#).

At first blush, China's reliance on the American market has clearly fallen, driven in no small part by the two countries' tariffs. By the end of 2025, China's share of US imports had fallen to 9 percent, down from a peak of over 20 percent in 2017.<sup>4</sup> That said,

4 US Census Bureau, [US trade in goods with China](#) and [US trade in goods with world](#), seasonally adjusted.

a significant portion of Chinese manufacturing remains tied to US demand through “connector countries” (Freund et al. 2024). China has also pursued an active trade policy with other countries: since 2021, it has signed upgraded or new free trade agreements (FTAs) with New Zealand (2021), Ecuador (2023), Nicaragua (2023), Serbia (2023), Singapore (2023), and Peru (2024).<sup>5</sup> And it is a member of the Regional Comprehensive Economic Partnership (RCEP), which came into force in 2022. Of these, RCEP offers the biggest increase in market access; the other FTAs offer less in terms of substantial diversification.

In spite of these reallocations in trade flows, the dual circulation strategy remains hobbled by China’s weak domestic economy. (The sources of weakness have been extensively covered elsewhere and are not discussed in depth here (Wright 2026).) Major factors include the negative wealth effect from China’s property slump (Huang 2024). The producer price index showed 41 consecutive months of deflation between October 2022 and February 2026, and the consumer confidence index has sat below 100 points continuously since April 2022 (National Bureau of Statistics of China 2026a, OECD 2026).<sup>6</sup> As a result, and additionally boosted by industrial policy, net exports have become a larger contributor to GDP growth, accounting for 1.5 and 1.6 percentage points out of 5 percentage points of GDP growth in 2024 and 2025, respectively (National Bureau of Statistics of China 2025, 2026b).

With weak domestic demand driving some of China’s export competitiveness, trade tensions have emerged not just with developed economies: of the nearly 200 trade investigations against China in 2024, more than 110 were initiated by emerging economies such as Turkey, Brazil, and India ([figure 2](#), McMorrow and Ding 2025).

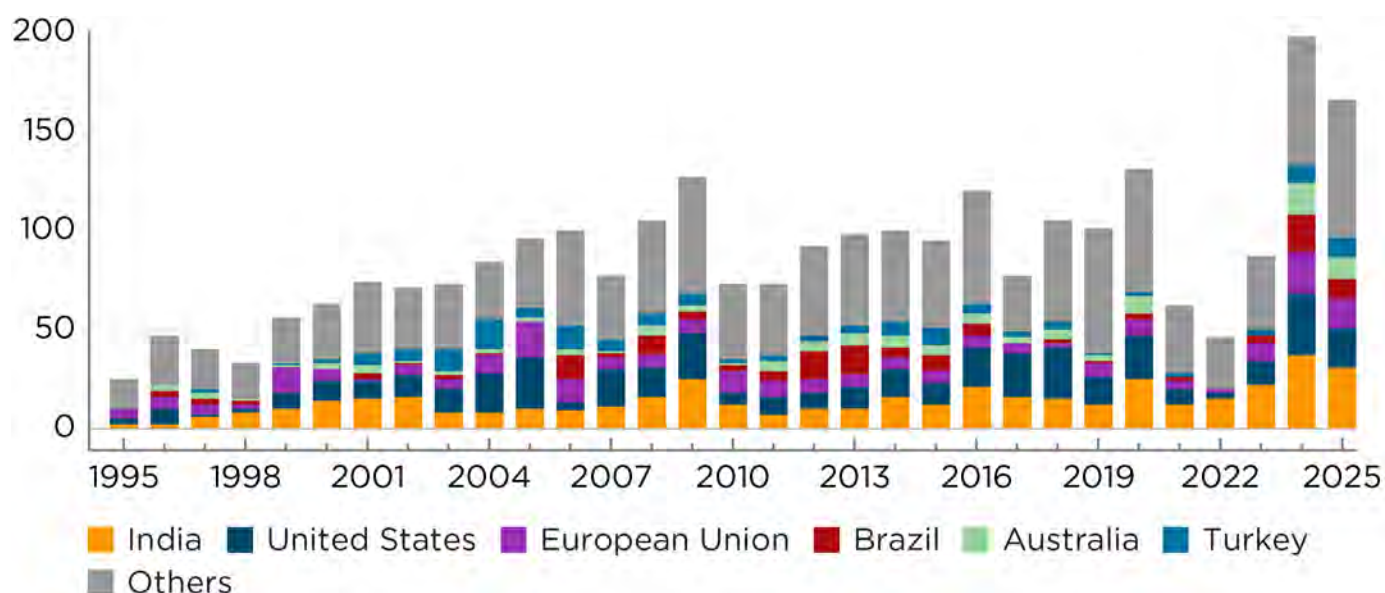
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5 Ministry of Commerce, [China FTA network](#).

6 Trading Economics, [China producer prices change](#).



Figure 2

**Trade investigations against China, 1995–2025**

Sources: [Ministry of Commerce](#), [McMorrow and Ding \(2025\)](#).

The government has introduced numerous policies to boost domestic demand by strengthening internal flows of goods, services, and people.<sup>7</sup> Efforts to boost household consumption have been backed by a slew of policies: support for big-ticket purchase items such as cars and home appliances; enlargement of service, digital, and rural consumption corridors (NDRC 2023, General Office of the State Council 2023); service promotion in child care and elder care, culture and sports tourism, and services demanded by the elderly population (the so-called “silver economy”); and investment in the automotive, electronics, tourism, and housing sectors. Social expenditures have also been steadily increasing

7 These policies include (1) reducing local protectionism and internal market fragmentation to improve the efficiency of resource allocation; (2) strengthening domestic supply chains by leveraging interregional comparative advantages and mitigating the risks of industrial relocation; (3) stimulating consumption by improving welfare support, with the aim of absorbing excess capacity through domestic demand and facilitating industrial transformation; and (4) promoting the commercialization of technological innovation to generate new sources of demand. See Yicai (2025) and QSTheory (2025).



since 2010 (Lardy 2025). Recent welfare reform measures bring incremental changes in pensions and social services for migrant workers (State Council of the PRC 2024, General Office of the CCP Central Committee and General Office of the State Council 2025).

Some of the deficiencies in these policies have been widely discussed. For example, trade-in and upgrade programs merely bring future consumption forward to absorb current industrial production. That said, the combined effects of welfare reforms will take some time to play out. On the one hand, pension reform and health insurance expansion have been shown to raise consumption levels, but on the other hand, China's social insurance funds are increasingly under pressure, faced with the fiscal burden of an aging population under a pay-as-you-go system (Huang and Zhang 2021; Bai and Wu 2014; Liu, Ma, and Zhao 2023). According to projections by the Chinese Academy of Social Sciences, the cumulative pension fund surplus is expected to peak in 2027 and be depleted by 2035 (Zheng 2019). Although measures (e.g., raising the retirement age) have been introduced to try to address this pressure, precautionary savings may increase rather than decrease if public anxiety about system solvency is not sufficiently addressed (Standing Committee of the National People's Congress 2024). If successful, these combined policies might, in time, push China further along in increasing its consumption share of GDP, as discussed in recent PIIE research (Lardy 2025).

Other policies involve building a unified national domestic market, by breaking down interprovincial barriers in the movement of goods, services, and data (CCP Central Committee and State Council 2022). Local protectionism means that China's domestic markets are fragmented, a result of practices such as interjurisdictional checkpoints on roads, local government procurement rules that discriminate against firms from other localities, and rules that require in-province firm registration. One study using logistics freight data found that interprovincial barriers significantly raise trade costs and suppress commerce between provinces (Zhang, Guo, and Wu 2024).

China is also seeking to reduce regulatory barriers for export-oriented firms to sell in the domestic market, thereby shielding these firms to some degree from unexpected shocks to external

demand. A new certification procedure aims to enable goods processed on the same production line to be sold on both external and domestic markets. Bonded warehouses have been introduced that service both export and domestic sales, alongside subsidies for exporters to access domestic e-commerce platforms. Evidence of the effectiveness of these measures is mixed. Insufficient knowledge of a very different market environment is a significant barrier. A 2021 survey of more than 600 foreign trade machinery and electronics companies found that 57 percent of them reported having no experience in domestic sales (Outlook Weekly 2024). While some success stories have been showcased, there are also reports of exporter reluctance to switch to domestic sales due to higher payment risks, and intense price competition that cuts profit margins in domestic markets (Gao, Zhang, and Hall 2025).

China's dual circulation strategy, then, is experiencing domestic challenges. Although the government has been proactive in designing and enacting measures to remove barriers and expand the dynamism and resilience of the country's domestic economy, major challenges remain.

## **Self-Reliant Technology Innovation as the New Driver of Growth**

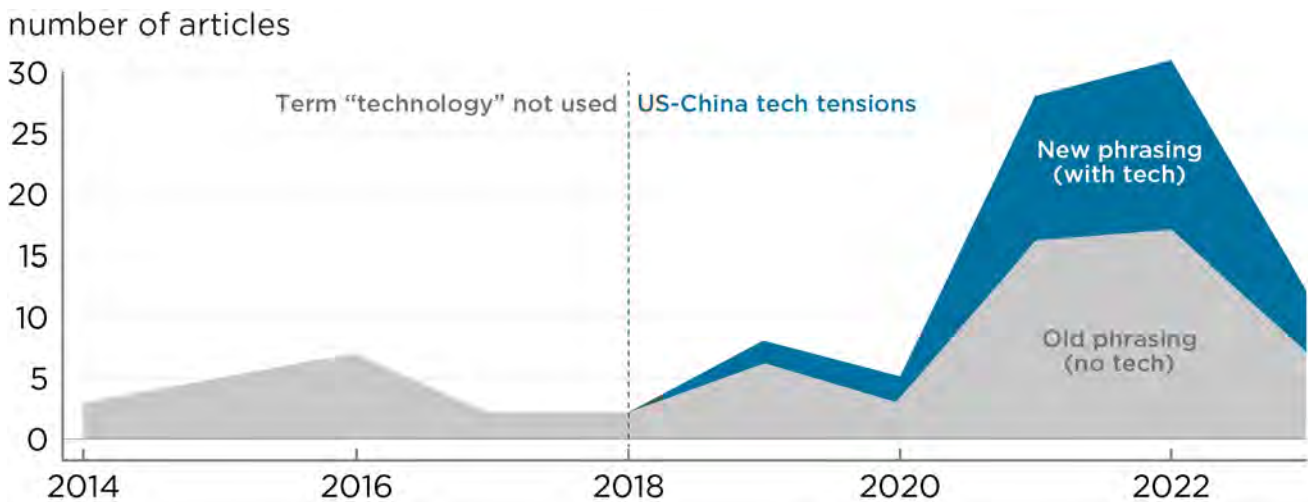
The second component of China's economic security growth model aims to shift the domestic economy away from debt-fueled property development and toward self-reliant high-tech innovation as the main growth driver. While science and technology (S&T) advancement has always been a high priority for the Chinese government, the current focus is driven by a national security imperative.

This shift to security logic is demonstrated in official language, such as China's formulation of its "comprehensive national security concept." The 2015 National Security Law did not include technology in its formulation of national security, but rather called for "mak[ing] military, cultural and social security their safeguard" (NPC Observer 2015). After 2018, however, a change in official formulation can be detected. As [figure 3](#) shows, *People's Daily* articles published before 2018 invoking the comprehensive national security concept do not include the term "technology." Since

2018, a number of articles call for making “military, *technology*, cultural, and social security [the] safeguard” of national security (emphasis mine).

Figure 3

**Change in formulation of China’s comprehensive national security concept, 2014–23 (based on analysis of terms appearing in *People’s Daily* articles)**

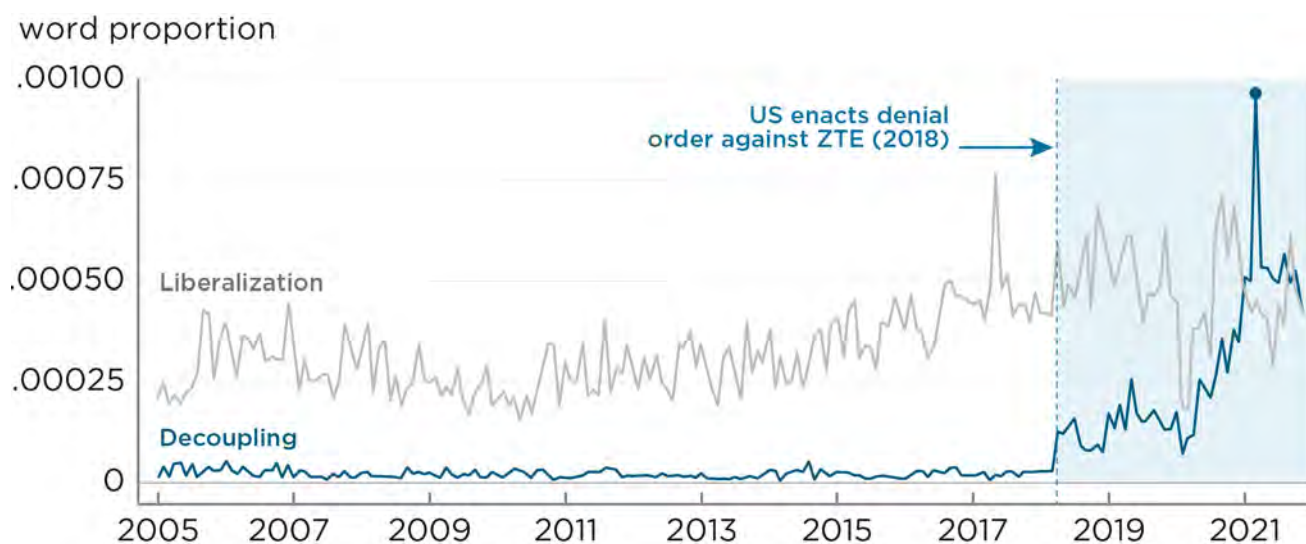


Source: Author’s calculations from *People’s Daily*.

Accompanying the elevation of technology into China’s conception of national security is a turn toward a view of globalization as a source of vulnerability rather than opportunity for technology gains. This can be captured through an analysis of trends in China’s official propaganda. Figure 4 shows the changing prevalence of language related to international liberalization as opposed to language related to decoupling across 480,000 news articles about science and technology from 2005 to 2022. The former consistently exceeds the latter over most of this period, but from 2018 onward there is a sharp rise in decoupling language. In 2019, the CCP Central Committee’s Fourth Plenum endorsed a “new-style whole-of-nation system” for science and technology, signaling that breakthroughs in “chokepoint” technologies had become a collective national mission (Xinhua 2019). In 2021, the year of the release of the 14<sup>th</sup> Five-Year Plan, language related to decoupling spiked and exceeded language related to external liberalization for the first time.

Figure 4

### Prevalence of language related to decoupling and external liberalization in Chinese news articles, 2005–22



Source: Tan et al. (2025).

The pivot to self-reliance is also reflected in major institutional and policy shifts. Beijing overhauled its S&T bureaucracy in spring 2023, centralizing political guidance over the innovation space (Naughton et al. 2023). A Central Science and Technology Commission, under the CCP Central Committee, now sits above a trimmed-down Ministry of Science and Technology, a reorganization justified as necessary to meet “the severe situation of international technological competition and external containment and suppression” (State Council of the PRC 2023).

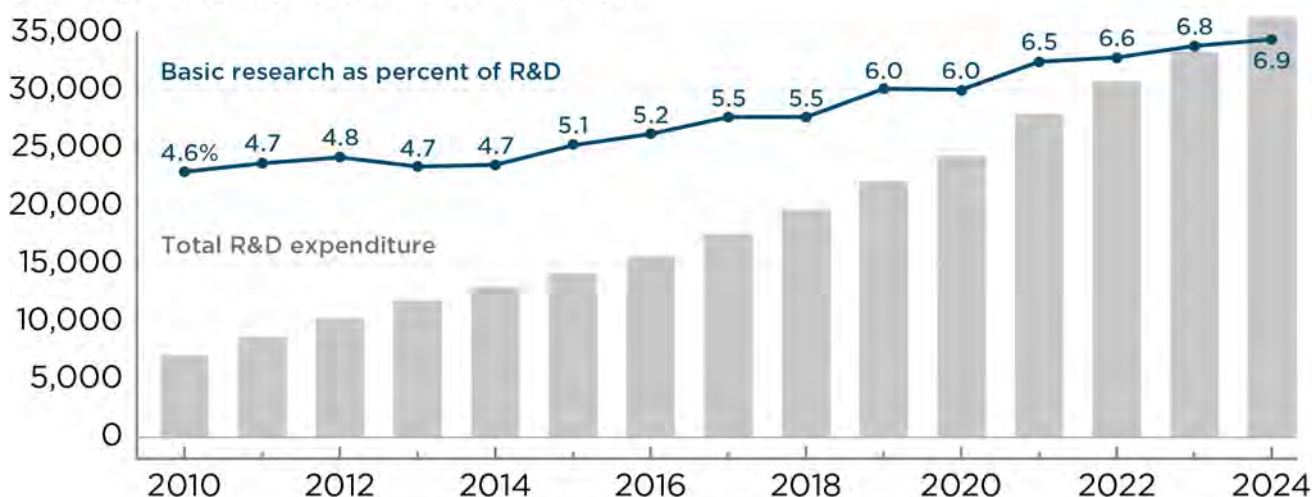
Fiscal policy also backs the self-reliance drive: the 2021 budget report pledged to “vigorously support scientific and technological self-reliance and self-strengthening,” lifting outlays for basic research by 10.6 percent (Ministry of Finance 2021). The share of basic research in overall research and development (R&D) expenditure was between 4.6 and 5.5 percent from 2010 to 2018, rose to 6 percent in 2019, and since 2020 steadily increased to nearly 7 percent by 2024 (figure 5). In line with the new growth strategy, central government allocation for science and technology has been on an upward trajectory, increasing by 7.13 percent in 2024–25, and by 10 percent in 2025–26, outstripping even the

increase in allocation to national defense and public security (Ministry of Finance 2025, 2026).

Figure 5

### China's R&D expenditure and share allocated to basic research, 2010–24

total R&D expenditure (100 million yuan)



Source: National Bureau of Statistics of China, [Annual data](#).

Industrial policies also show a new urgency. Capital market measures were introduced (e.g., expanded STAR and ChiNext boards) to channel domestic equity to technology firms, giving them an alternative to foreign listings (Brown, Chimits, and Sebastian 2023). A 2019 State Council directive urges national high-tech zones to mobilize firms and universities to make “breakthroughs in major ‘chokepoint’ technologies and products” (Tan et al. 2025). Other place-based industrial policies have also increased their focus on self-reliant innovation, embedding the security logic at the local level (Xu, Liu, and Wu 2025). Government procurement serves as another tool. For example, US sanctions on Chinese firms have resulted in more procurement contracts awarded to firms adjacent to the sanctioned target, as a way of boosting other, nonsanctioned firms in the sector (Li 2024).

The focus on innovation as a national security imperative has substantially impacted education policy. In 2023, the Ministry of Education announced a restructuring of university majors and

disciplines, with a focus on building new colleges for technology, science, and engineering (Xinhua 2023). While this reform in part reflects labor market pressures on humanities and social science graduates, the government is clearly intent on actively boosting the country's supply of S&T human capital. According to Chinese media, the Ministry of Education approved the cancellation of 1,422 humanities programs between 2019 and 2022 (Yu 2025). Fudan University, long considered a leading humanities institution, announced that it would reduce its share of students enrolled in humanities subjects from 30–40 percent to 20 percent (Southern Weekly 2025).

Accompanying the decline in humanities education is a corresponding increase in engineering and science. In 2020, 51.4 percent of new undergraduate programs approved by the Ministry of Education were in science and engineering, and by 2024 this proportion had increased to 61.6 percent ([table 1](#)). Unsurprisingly, the specific majors that have been approved are overwhelmingly in subjects such as artificial intelligence, big data, and digital technology, as well as engineering ([appendix table A.1](#)). In addition, a Ministry of Education (2020) “plan for strengthening basic academic disciplines” offers preferential admission to high-performing students in foundational subjects such as chemistry, physics, and mathematics. Initiatives such as the “Young Talent Support Plan” aim to direct sustained funding, faculty recruitment, and academic exchange opportunities toward top-performing STEM students in college (Ministry of Education 2018, 2024a).

Such trends will likely exacerbate China's existing structural bias toward the hard sciences. In 2024, one-third of China's college graduates were in engineering (1,718,800) and 6.2 percent were in science (319,710). This compares to 4.9 percent in economics (249,628) and 3.6 percent in law (186,495). The same trends are exhibited in postgraduate education: 35.2 percent of China's new postgraduates in 2024 were in engineering (381,725) and 7.5 percent in science (81,087), compared to 4.4 percent in economics (47,649) and 6.3 percent in law (67,784) (Ministry of Education 2025). It is unclear how these policies will impact China's economy and innovation capabilities in the long term, but the trends indicate that the shift to economic security is structural, and will have a generational impact on China's economy and society.



Table 1

### New undergraduate program filing and approval by the Chinese Ministry of Education, 2020–24

| Program              | 2020         | 2021         | 2022         | 2023         | 2024         |
|----------------------|--------------|--------------|--------------|--------------|--------------|
| <b>Total</b>         | <b>2,223</b> | <b>1,961</b> | <b>1,817</b> | <b>1,673</b> | <b>1,839</b> |
| Science              | 205          | 199          | 208          | 170          | 193          |
| Proportion (percent) | 9.2%         | 10.1%        | 11.4%        | 10.2%        | 10.5%        |
| Engineering          | 938          | 794          | 762          | 739          | 940          |
| Proportion (percent) | 42.2%        | 40.5%        | 41.9%        | 44.2%        | 51.1%        |

Source: Ministry of Education (2021, 2022, 2023, 2024b, 2025).

### Toolkit for Economic Countercoercion: From Symbolic to Substantive Controls

In response to an increasingly adverse geopolitical environment, China has introduced legislation to insulate its economy from external pressure and to enhance the state’s capacity to counter perceived instances of foreign economic coercion. A new legal architecture now provides an expansive definition of national interest justifying China’s use of economic tools to uphold its national “sovereignty, security, and development interests.”<sup>8</sup> Within that ambit, specific legislation underscores China’s prerogative to retaliate against perceived external interference (see [table A.2](#) in the appendix).

8 This phrase draws on a few party and policy documents dating back to the late 2000s and early 2010s. Legislatively, such language first appeared in the main text of the 2015 National Security Law, and since 2020 has appeared in the opening articles of the National Defense Law (2020), Data Security Law (2021), Anti-Foreign Sanctions Law (2021), Law on the Protection of the Status, Rights and Interests of Military Personnel (2021), Foreign Relations Law (2023), Foreign Trade Law (2025), and Ethnic Unity and Progress Promotion Law (2026).

The Anti-Foreign Sanctions Law (2021) authorizes countermeasures such as asset freezes and visa restrictions against foreign entities that enforce “discriminatory” measures, thereby exposing multinational firms to potentially conflicting legal demands. The Foreign Relations Law (2023) consolidates this principle by affirming the use of countermeasures and sanctions as legitimate instruments of statecraft. The 2025 revision to the Foreign Trade Law expands the ambit of tools authorized for retaliation. Unlike earlier provisions that restricted the use of trade countermeasures to acts of discrimination, the revised law enables China to prohibit or restrict foreign trade in response to threats to its sovereignty, security, or development interests, substantially expanding the range of legitimate circumstances under which trade controls can be enacted.

Under the National Security Law, the Measures on Blocking Improper Extraterritorial Application of Foreign Laws and Measures (2021) empower Chinese authorities to prohibit domestic firms from adhering to foreign extraterritorial sanctions and entitle affected firms to pursue damages in Chinese courts. Complementing this, the Unreliable Entity List (UEL; 2020), promulgated under the Foreign Trade Law and National Security Law, establishes a mechanism to impose restrictions on foreign firms and individuals deemed to jeopardize China’s sovereignty or security. In parallel, the Export Control Law (2020) created China’s first comprehensive framework for regulating exports of dual-use goods and technologies, granting the state considerable discretion to impose licensing requirements under the rubric of national security. Implementing regulations were enacted in 2024, alongside lists of controlled items and a mechanism for restricting exports to specific firms. The 2024 Tariff Law elevates authority over retaliatory tariffs to the State Council, and also authorizes countermeasures if a party fails to honor its trade commitments to China. The 2026 Regulations on Industrial and Supply Chain Security authorize trade restrictions against foreign firms in the event of threats to China’s supply chain security.

Collectively, these statutes and regulations reconfigure China’s policy environment by connecting economic security, sovereignty, and foreign policy under an expansive framework (Medeiros and

Polk 2025). But the thicket of new legislation has so far been put to use unevenly. The UEL, for example, sat empty until 2023 when two US companies, Raytheon Missiles and Defense and Lockheed Martin Corporation, were listed. Even then, public analysis of this move was that the listing was largely symbolic, given that the target was the defense rather than commercial branches of both companies and the limited exposure of those branches to the domestic Chinese market (Reuters 2023). Since then, many more firms have been placed on the UEL (table 2). As of April 2025, the anti-foreign sanctions list has had 114 individuals or organizations added since 2021 when the law first came into force, but, again, the listings appear to be more symbolic than substantive (OpenSanctions, n.d.; Ministry of Foreign Affairs, n.d.; Bohman, Wong, and Ferguson 2025).<sup>9</sup>

Table 2  
**Usage of China’s Unreliable Entity List and Export Control Entity List**

|                                            | Unreliable Entity List                                  | Export Control Entity List                               |
|--------------------------------------------|---------------------------------------------------------|----------------------------------------------------------|
| Total entries listed (as of July 12, 2026) | 72                                                      | 139                                                      |
| Suspended (through -November 9, 2026)      | 11                                                      | 16                                                       |
| No longer in effect                        | 17 (11 from November 10, 2025 + 6 from August 12, 2025) | 27 (15 from November 10, 2025 + 12 from August 12, 2025) |

Source: Ministry of Commerce Bureau of Industry, Security, Import and Export Control; Wang, Ye, and Qiu (2025).

9 See OpenSanctions, [Sanctions issued under China’s Anti-Foreign Sanctions Law \(CN-AFSL\)](#) [Archived April 29, 2025], Wayback Machine; and [Chinese government sanctions](#) [Dataset].

The new legal tools mark a shift in how political tensions affect Chinese trade policy. Even before today's geopolitical competition, China's trade flows were not free from politics, notwithstanding substantial efforts to liberalize trading rights, reform the legal framework for trade, and shift state-owned enterprise (SOE) trading behavior toward a more commercial orientation after China's entry into the WTO (Tan 2021, Tan and Davis 2023). Prior to 2020, China did not have a legal basis for enacting export restrictions beyond its adherence to multilateral nonproliferation norms and WTO commitments. Scholars have argued that the PRC's experience of being sanctioned has led it to adopt foreign policy positions rejecting the use of economic sanctions and to portray such tools as illegitimate and counterproductive (Poh 2021).

Despite these legal and rhetorical constraints, China regularly used trade as a tool to signal its displeasure whenever a trading partner crossed its red lines on issues related to sovereignty and national security. During this period after WTO entry but before the emergence of US-China trade and technology tensions, trade restrictions tended to be triggered by a narrow set of issues related to regional territorial disputes (e.g., maritime disputes with the Philippines), national sovereignty (e.g., perceived interference on issues related to Tibet, Taiwan, or Tiananmen), and perceived threats to national security (e.g., Korea's deployment of the THAAD missile defense system in 2016). Research has shown this to be a systematic pattern, with China more likely to impose import restrictions on the basis of health and safety concerns when bilateral tensions with a trading partner arise (Kim, Perlman, and Zeng 2025). This regulatory veil allowed China to express its displeasure without explicitly violating either its own rhetoric on the illegitimacy of sanctions or WTO rules. In 2020, the range of issues that would trigger such trade restrictions appeared to expand, underscoring the vagaries of what falls within a national security lens, when China imposed restrictions on imports of Australian beef, wine, barley, and other products after Australia called for investigations into origins of the virus that causes COVID-19.

The impacts of such restrictions were uneven. When China imposed an import ban on Norwegian salmon after Chinese dissident Liu Xiaobo was awarded the Nobel Peace Prize, direct

exports of salmon to China fell dramatically, although studies found that Norwegian salmon continued to make its way into China via smuggling, rerouting, and certificate falsification (Chen 2016, Garcia and Nguyen 2023). Likewise, China's import restrictions on Australian products had a limited impact on Australian producers, who were able to find alternative markets (Australian Treasury 2021).

During the years without a formal export control framework, it is sometimes not clear whether restrictions were imposed at all. For instance, widespread coverage has been given to Chinese controls on rare earth exports to Japan in 2010 after a collision between a Chinese trawler and a Japanese Coast Guard boat near territorially disputed islands. Studies found, however, that patterns of actual Chinese rare earth exports to Japan during this dispute period were not consistent with what one might expect from an imposition of controls (Johnston 2013, Evenett and Fritz 2023). Another analysis noted that the Chinese government had announced a policy to reduce rare earth exports on a global basis two months prior to the collision (King and Armstrong 2013). And a fourth study suggested that the disruption was caused by local officials at a single port, acting without the authorization of China's central government (Klinger 2018). Such ambiguity demonstrates how the lack of a formal export control framework in this earlier period gave the Chinese government plausible deniability over potential acts of economic coercion.

China's new legal framework for economic countercoercion, then, marks a substantive shift in posture. Export controls and sanctions are now explicitly authorized within a national security framework, a departure from the use of health and safety as a regulatory veil. Rhetorically, China maintains its earlier position of opposing the illegitimate use of economic sanctions by framing its toolkit as primarily reserved for retaliation.

Unsurprisingly, it is also evident that China's mode and scale of retaliation have shifted. The trade war between the United States and China under the first Trump administration saw China responding to American tariffs in a proportionate manner. The US technology restrictions caught China off guard and in the initial period China found itself equipped with little in the way of

retaliatory tools. By the start of the second Trump administration in 2025, China had adopted a different approach. Not only did the Chinese government retaliate in response to the US Liberation Day tariffs in April 2025, it also deployed numerous other tools, from export restrictions on critical minerals to placing firms on the UEL and export control dual-use list, and antitrust investigations into Google, Nvidia, and DuPont. In October 2025, in seeming response to the US Commerce Department Bureau of Industry and Security's revision of its rule on foreign subsidiaries of entities named to export control and sanctions lists, China announced a series of export controls on rare earths and associated technologies, among other items. These controls also for the first time invoked an extraterritorial rule that places licensing restrictions on firms and individuals outside China seeking to ship goods containing Chinese-origin rare earths of at least 0.1 percent of their value or goods made using export-controlled rare earth technology to other parts of the world.

While these escalatory measures were temporarily suspended at a summit in South Korea in October 2025, the moves reflect an underlying shift by Beijing from proportionate retaliation to strategic escalation in order to gain negotiating leverage. The types of restrictions have also changed. Whereas previous trade restrictions targeted major imports from a particular state (e.g., Norwegian salmon) that would cause minimal harm to Chinese consumers or producers and did not deny access to alternative markets for foreign producers barred from exporting to China, China's leveraging of its rare earth supplier position surgically selects inputs where it has asymmetric chokepoint capabilities. These restrictions disrupt a wide swath of foreign industries, from defense equipment companies to auto manufacturers and more. But such moves also have a more targeted impact on producers in China, by curbing external demand. And whereas previous trade-related retaliations were limited to bilateral relationships, China's latest round of export controls has spillover effects on third countries that threaten to reverberate through critical parts of the global industrial system.



### III. FUNDAMENTAL TENSIONS OF AN ECONOMIC SECURITY GROWTH MODEL

*“(O)ur national security is not for sale. Our national security does not have a price tag.”*

—Stephen Kinnock, UK Member of Parliament, December 1, 2020

It remains unclear whether China will succeed in “coordinating development and security” to generate growth while also reducing national security threats. The attempt to optimize the two objectives potentially distorts both normal decision making for firms and economic policymaking for government. Moreover, an economic security growth model has distributional effects, creating new bureaucratic and commercial winners and losers, and reconfiguring the interest groups that can influence policy. I focus on three types of tensions in particular: (1) the regulatory imbalance resulting from an emphasis on demonstrating a credible threat, (2) the role of risk aversion in driving behavior, and (3) resource misallocation leading to excess capacity.

A primary challenge in applying a national security logic to economic policymaking is the breakdown of standard cost-benefit analysis. In a market economy, the ability of firms and policymakers to use constrained maximization in their decision making allows for more efficient resource allocation that boosts both profits for firms and public service provision for governments. National security considerations are treated as instances of market failure justifying government intervention that override the use of a cost-benefit framework. These cases, however, are normally considered the exception rather than the rule. China’s shift to coordinating security and development in its national guidances signals a rejection of this traditional approach.

When security considerations enter the calculus not as an exceptional case of market failure but as a necessary component of economic decision making, policymakers and firms find themselves needing to maximize two objective functions across a far wider array of issues. Standard logic on the gains from exchange takes second place if security, rather than comparative advantage, drives policy. And the justification for industrial policy on national security

grounds may proliferate across sectors. Meeting both economic and security objectives in many cases requires making a trade-off if the two goals are not naturally aligned. But the process for making an objective assessment of the trade-off between security and economic objectives is not at all clear. The call may end up being made on the basis of risk appetite, values, political calculation, or other criteria apart from economic rationality.

The need to balance between economic and other objectives is not new. The challenge of balancing between growth and environmental protection, for example, has long been the subject of research and policy. In this case, however, the assessment is arguably more tractable. Positive and negative externalities, alongside probabilities and degrees of confidence, are more easily calculable, making the maximization process more compatible with traditional cost-benefit analysis. Economic policymaking itself also involves trade-offs across different objectives (e.g., unemployment and inflation). In such cases, again, the costs involved in leaning toward one objective versus the other are more easily calculable.

When it comes to incorporating security considerations in economic decision making, uncertainty undermines standard approaches. While the social and economic impact of a 1 percent chance of a component malfunction for an ordinary product might be straightforward for a firm to calculate, the same cannot be said for national security. From the outset, it is difficult to attach probabilities and confidence intervals to a security vulnerability: National security is contingent on geopolitical developments and assessments of intent, both of which are by nature uncertain and dynamic. A foreign investment project might be of low risk today, but high risk ten or even five years later. Moreover, even when the probability of a security vulnerability can be accurately calculated, the resulting social, economic, and political costs of the potential impact are challenging to assess.

While some of these challenges have been salient for decades, technological progress adds new complexity to decision making. The incorporation of sophisticated and emerging technologies in social and economic systems makes risks much more difficult to calculate. Vulnerabilities might be hidden deep in the technology stack, embedded in nontransparent supply chains beyond national

boundaries, or buried in algorithms that manipulate the public information environment (Tan et al. 2025).

Given these fundamental uncertainties with assessing security risks, there is an overarching tendency to allocate disproportionate weight to national security and political risk considerations in economic decision-making, among both governments and firms (Bauerle-Danzman 2025, Buzan, Wæver, and de Wilde 1998). As a result, new tensions have emerged in economic governance, as illustrated in the following discussion on China.

## Regulatory Imbalance

The first major change in China's policy direction is in the regulatory push to demonstrate that the government can pose a credible counterthreat to US restrictions in trade and technology. With the need to mobilize across a large and decentralized party-state apparatus, China has deployed political campaign rhetoric and administrative mechanisms to highlight its shift in policy focus. Since the early 2020s, the call to "coordinate development and security" has proliferated across economic policies.

The emphasis on security in China's high-level economic guidance has intensified over time. This is evident in the official recommendations for the 15<sup>th</sup> Five-Year Plan, which substantially expand the discussion of national security compared to the 14<sup>th</sup> Plan, and adopt more overt tones of political mobilization. Indeed, what some might consider martial language appears to be diffusing across China's economic policies, theoretical guidance, and even legislation. The 15<sup>th</sup> Plan recommendations, for example, call for the strengthening of the "*struggle* against sanctions, interference, and 'long-arm jurisdiction'" (here and in the following quotations, I emphasize the word "struggle") (CCP Central Committee 2025). In an article in *Qiushi*, the CCP's leading political theory journal, Xi (2022) cited the importance of "utiliz[ing] the rule of law in international *struggles*," including in "laws and regulations to counter sanctions, interference, and 'long-arm jurisdiction.'" The official explanation of revisions to China's Foreign Trade Law notes specific changes aimed at "enriching and improving the legal toolbox for foreign *struggles*" (Wang 2025). But the use of "struggle" as applied to China's foreign economic laws, policies,

and party guidance is less a call to arms and more a signal to the domestic bureaucracy that it should prioritize and strive toward producing a credible response to American economic policies toward China (Kim and Prytherch 2023).

On the one hand, the legislative push to establish counterleverage to US technology restrictions appears to have proven effective. The truce that Presidents Trump and Xi reached in South Korea in October 2025 has been widely attributed to China's ability to threaten costly disruption in sectors deemed critical to American national security through controls on exports of rare earths and critical minerals (Chan et al. 2025). Unlike the Phase 1 agreement signed in the first Trump administration, where the bulk of adjustment fell to China, this time both countries agreed to suspend certain restrictions.

On the other hand, the political mobilization and emphasis on establishing a counterthreat has arguably led to a policy imbalance. Relatively less weight has been given to the countervailing need for China to maintain credibility in ensuring a predictable and welcoming business environment for investors. In the call for coordinating between security and development, a regulatory tilt appears to have emerged that favors security over development.

This regulatory imbalance can be seen from a simple count of laws that were recently passed or amended. Since 2019, seven laws have been passed or amended that directly affect foreign economic relations. Two of them, the Foreign Investment Law and Foreign Trade Law, contain a mixed set of provisions that both liberalize and securitize the flows of capital, goods, and services.<sup>10</sup> Four—the Tariff Law, Export Control Law, Foreign Relations Law, and Anti-Foreign Sanctions Law—are primarily focused on strengthening China's countercoercion capabilities in its foreign economic policy toolkit. Only one, the Hainan Free Trade Port Law

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10 The Foreign Investment Law, for example, adopts a negative list for investment that reduces administrative approval for a wide swath of sectors while explicitly restricting a narrower set, and also introduces a national security screening mechanism. The amendments to the Foreign Trade Law, as previously discussed, both strengthen China's ability to retaliate against foreign trade partners and add provisions for free trade zones.

passed in 2021, is centrally about liberalization, and it applies only to the small geographical scope of Hainan Island (National People's Congress 2021).

## **Risk Aversion**

Bureaucratically, interagency discussions between economic and security agencies are more likely to give deference to security concerns out of an abundance of caution, including to avoid the reputational and credibility risks of having to take the blame in the event that national security is compromised (Bauerle-Danzman 2025). Firm-level decision making likewise shifts away from standard profit-maximizing logic. Research has found, for example, that foreign firms invested in China have exited more out of political risk considerations than because of the economic impact of tariffs (Vortherms and Zhang 2024). A recent business confidence survey found that two of the top three challenges that EU firms expect to most impact their business are related to geopolitical risks and US-China tensions (European Union Chamber of Commerce in China 2024).

The American Chamber of Commerce in China (2025) reports similar trends in its survey of firms invested in China, with regulatory concerns feeding into the uncertainty. For example, across all sectors, a majority of US firm respondents noted that data localization rules under China's Cybersecurity Law had had a negative impact on their competitiveness and operations in China, with firms in the technology and R&D space most negatively affected (82 percent). Apart from shifting their supply chains or exiting, foreign firms that stay in China might also reduce their footprint in country. Data from China's National Bureau of Statistics show that 2023 saw a new low in foreign company employment numbers in China, falling below 10 million to a level comparable to 2009 (Nurmamat 2024).

Chinese firms, too, face the challenge of balancing between national security risks and profit making. On the one hand, incentives between the party-state and technology firms are more aligned compared to the period before the rise of US-China technology rivalry. This means that the existing instruments that the government can use to influence private sector behavior

have become more effective. The threat for Chinese firms of suddenly finding themselves deprived of critical inputs because of American export controls makes them more likely to respond to the party-state's call for self-reliant innovation (Chen and Evers 2023). Firms that are more exposed to US sanctions are also more likely to be given government protection (Li 2024). On the other hand, the elevation of innovation to a high-level political priority has intensified competition among Chinese technology firms for market share. This greater competition might make it more difficult for Chinese firms to completely wean themselves off foreign technology, if continued reliance on these inputs means that they can stay ahead of their competitors. Reported uncertainties about whether Beijing would lift its restriction on Chinese companies' purchase of Nvidia's H200 chips reflect the difficult trade-offs involved (Cherney and Mo 2026, Reuters 2026).

## Resource Misallocation

The high-level push for self-reliant innovation separates favored from unfavored sectors and alters the competitive landscape across and within sectors. Because political guidance, fiscal expenditure, lending, and human capital development are all focused on S&T-intensive industries, other sectors (apart from property development) will no doubt be impacted. These include not just traditional labor-intensive and low-value-added manufacturing such as apparel and food and beverage but also the services sector.<sup>11</sup> Recognizing such anticipated distortions, research has found that China's high-tech industrial policies drive greater resource misallocation, resulting in lower aggregate total factor productivity (Garcia-Macia, Kothari, and Tao 2025).

A second consideration pertains to regional differences in comparative advantage, particularly in human capital endowment. While the national push for high-tech innovation naturally privileges a few locations (e.g., Beijing, Jiangsu, Shenzhen, and Zhejiang), it is unclear whether, or how, the rest of the country could likewise

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11 While the central government has pushed for rural entrepreneurship and agricultural industrialization in recent years, implementation is undermined by local incentives that threaten to reinforce rather than reduce regional inequalities (Xue et al. 2021).



shift to high-tech innovation. With the simultaneous push to wean the country off property-led growth, some localities (e.g., Tier 3 and Tier 4 cities or townships in China's interior) will likely find themselves with no obvious replacement growth engines. How should they respond to the current policy focus on high-tech innovation?

A recent large-scale analysis of Chinese industrial policies showed that top-down guidances drive local governments to adopt policies that match central government priorities (Fang, Li, and Lu 2025). As a result, over time, local policies increasingly resemble each other and promote similar industries regardless of resource endowments. The effectiveness of industrial policies then declines, as the mismatch between targeted industries and underlying comparative advantage expands. This leads to wasteful investment in places that have low odds of success as well as duplicative investment that does not follow demand signals, leading to excess capacity.<sup>12</sup>

The prospect of excess capacity in innovation-intensive sectors is unclear at the moment (and empirically difficult to assess), but some initial signals in the artificial intelligence (AI) domain suggest it might be of concern. In 2023 and 2024, a rush into the sector meant that more than 500 new data center projects were announced across the country, with 150 completed before the start of 2025. Yet reports suggest that only 20 percent of China's newly built computing power is being used (Chen 2025). The government's original strategy of "Eastern Data, Western Compute" had planned for data centers to be built in China's western and rural regions, which have cheaper land and electricity prices and

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12 There is little agreement in the literature on the definition of excess capacity and its likely causes (subsidies, global imbalances, or domestic political competition) (Guo et al. 2025, Mao and Xu 2024, Rotunno and Ruta 2024, Zhou 2004). This paper relies on the Chinese government's own definition of excess capacity, which broadly refers to a situation where the production capacity of an industry exceeds effective demand to such a degree that capacity use rates fall significantly below what would be internationally normal, leading to a reduction in efficient resource allocation, a waste of social resources, the holding back of industrial upgrading, and a loss in firm profits (State Council of the PRC 2013, Zeng 2025).

more amenable conditions for cooling, to service the data demands of the industrialized Eastern regions. But challenges emerged, including low latency speeds, which meant inefficient transmission of computing power, and a supply-demand mismatch (Mu 2024).

By mid-2025, the National Development and Reform Commission (NDRC) had already issued guidances to raise the bar for approvals of new data center investments as well as a ban on localities investing in small-scale projects (Reuters 2025). Similar trends are emerging in other high-tech industries. By the end of 2025, the NDRC was also warning of excessive, duplicative investments in humanoid robots, as more than 150 such companies had been established in the country in a short period of time (Wu 2025).

While clearly aware of such tendencies toward supply and demand imbalances, the government also appears willing to tolerate some degree of overcapacity in innovation industries in the name of spurring competition. A recent NDRC (2026) report, for example, calls not only for strengthened regulatory tools to reduce production capacity in mature industries (including electric vehicles and solar panels), but also for emerging industries (e.g., semiconductors, industrial software applications) “to maintain moderate capacity redundancy so as to promote competition and innovation.”

Another factor to consider is the impact on the labor market. While the drive for innovation-driven growth seeks to promote a high-skilled talent pool, the resulting prospects for lower-skilled workers, including the migrant workforce, are less obvious. Employment for manual labor should continue to some degree, as China continues to build out high-tech infrastructure (from charging stations to data centers and “smart cities”). However, automation also means that new factories already require less low-skilled labor, a trend that is likely to be accelerated with AI. China is also already a world leader in robot adoption, a trend driven in part by rising labor costs and associated with greater job losses and declining wages (Cheng et al. 2019; Fan, Hu, and Tang 2021; Giuntella, Lu, and Wang 2022). While many of these effects follow logically from technology advancement, the national security importance attached to China’s new policy direction means that effects on the labor market could be amplified or sped up.

#### IV. IMPACT ON THE US-CHINA SECURITY DILEMMA

How might these domestic tensions affect China's external relations, in particular with the United States? Both countries have repeatedly asserted that they do not seek conflict with each other. A security dilemma can nevertheless emerge when actions taken by one state are deemed by the other to pose a security threat, triggering countermeasures that in turn raise the threat perceptions of the first state. The result is an escalatory spiral that risks leading both countries into unintended conflict. While much international security scholarship has examined the factors driving such escalatory spirals in the form of arms races, and how to avoid them, less is known about how economic policies based on national security might lead to unintended conflict.<sup>13</sup>

Classic literature on the military security dilemma points to several sources of unintended escalation. The first focuses on the offense/defense structural balance; other channels concern the ways information is processed or provided. Escalation can happen when information is filtered through biased cognitive frameworks that feed misperception; for example, when one state alters its military capabilities or posture on a defensive basis, and the actions are misperceived by the opposing state as being offensive in nature (Jervis 1978). Alternatively, incomplete information about the opposing state's strategic intent may generate uncertainty that incentivizes escalation; for instance, when there is no way to ascertain whether a state is fundamentally hostile and aggressive or only focused on ensuring its own survival, it may be rational for the opposing state to arm itself (Glaser 2010).

Such escalatory dynamics have long proven difficult to contain in the military realm. Emerging technology that is dual-use in nature has always created security challenges. With the weaponization of interdependent economic networks, greater ambiguity is introduced that will likely increase the risks of unintended escalation. The following factors contribute to such ambiguity.

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13 Literature on tit-for-tat spirals in trade policy focuses more on the overall welfare effects on trading nations, and less on spillovers into the security realm.

First, it is more difficult in the economic realm to distinguish between offensive and defensive actions. For example, a nation may enact industrial policy in strategic industries to build resilience against external shocks. This might be viewed as a defensive move, but could also have offensive implications if that nation appears to use its enhanced production capabilities to gain global market share, alter world prices, and potentially deprive other nations of access in times of emergency. Similarly, a nation might engage in stockpiling to reduce dependence on external markets and ensure supplies of critical products in crisis. But such actions may be perceived as offensive if the stockpiling results in higher world prices for other countries or if those countries interpret the stockpiling as preparation for a military offensive. Investment screening might be viewed by the enacting government as a primarily defensive policy, but considered offensive if it is perceived as depriving strategic companies of market access needed for global competitiveness or global standard-setting power (e.g., in telecommunications infrastructure), or if screening criteria create risk aversion among other governments that denies these firms access to deeper capital markets.

Given this offense/defense ambiguity, it also becomes challenging to gauge the economic equivalent of an offense/defense structural balance and whether a nation possesses “offensive advantage,” another feature that might drive strategic uncertainty. Even with a relatively straightforward definition of economic offense (weaponization of an economic chokepoint to deny access to a target state, for example) ambiguities still emerge in the analysis. A state has offensive advantage only if the target state is not able to find substitutes or use other channels to retaliate or escalate. Given the complexity of economic networks and the variety of inputs required for the functioning of an economy, a full assessment of the balance between offensive and defensive capabilities between two countries in economic terms can be near impossible.

Moreover, true chokepoints in the economy are rare (one such is the technology for chemical isolation of specific rare earths such as dysprosium or terbium, for which China holds over 95 percent market share). Many nations may have relative dominance in the

supply of one or more inputs or products, but the degree to which this gives them offensive advantage in an economic relationship is unclear. For example, at what point does import dependence on a particular good confer economic vulnerability versus a temporary disruption? This depends on a range of factors, including the speed at which substitutes can be found. Whether the tipping point from disruption into true insecurity rests at 75 percent or 65 percent dependence, or some other number, is unclear. Resolving this question can require complex economic modeling, but may just as easily depend on risk preferences. Policymakers who are highly risk averse may prefer full decoupling rather than managed dependence, regardless of the underlying degree of vulnerability.

A second way in which economic interactions generate greater ambiguities than military ones has to do with the ways information is transmitted and interpreted. In general, economic bureaucracies tend to be less hierarchically structured than their national security counterparts. Whereas the command and control hierarchies of national security apparatuses allow for relatively strong coordination and hence clearer external signaling, economic bureaucracies are usually organized without a clear chain of command and with weak cross-coordination. In the United States, for example, Federal Reserve independence means that monetary and fiscal policies are not necessarily coordinated (Nordhaus 1994); and trade policy authority is both shared and competed over between the US Trade Representative and Department of Commerce (Destler 2005).

Furthermore, while there always exists a gap between policy issuance and implementation, outcomes in the economic arena are arguably more likely to be poorly associated with the intent of economic policies. Economic outcomes are the result of the policies and actions of a multiplicity of government agencies and profit-maximizing firms rather than those of military units. Economic goals can also be broader in scope (e.g., development and growth), making their meanings ambiguous and subject to differing definitions. Greater uncertainty therefore exists as to whether a particular economic outcome is the result of well-executed intent or the product of actions by a loose collection of economic entities with varied interests.

The ambiguity between offense and defense, and the relatively less coordinated nature of economic policy and outcomes, both feed into greater uncertainty about intent and a higher likelihood of misperception. In particular, the risks of fundamental attribution error are higher, as it can be easier to assume that an outcome harmful to oneself is due to malign intentions by the other country, as opposed to an unintended consequence. As a result, the probability of miscalibrating a response that unintentionally triggers security dilemma dynamics is higher.

Having laid out these general dynamics, I now turn to specific ways that internal tensions generated by China's shift to economic security might inadvertently worsen the US-China security dilemma.

### **Regulatory Imbalance Erodes the Credibility of Assurances**

One of the core propositions of international security scholarship is that deterrence requires a balance between both a credible threat and credible assurance. This creates an incentive structure that gives the other state a choice: if it takes action A, it will be met with a punishment (threat); but if it does not take action A, then no punishment will be meted out (assurance) (Schelling 1966). A key challenge for policymakers, then, when deploying economic tools as weapons, is to clearly identify what constitute credible threats and assurances in the economic realm, and how each can be deployed in combination for deterrence.

At the rhetorical level, the Chinese government has tried to offer assurances about its desire to avoid conflict while simultaneously signaling its ability to retaliate forcefully against US actions. For instance, the Foreign Ministry has repeatedly stated to the United States that “China does not want to fight, but China is not afraid to fight” (Lin 2025). In April 2025 when the Trump administration released its Liberation Day tariffs and engaged in several rounds of tariff escalation with China, China responded with not only countertariffs but also a range of restrictions authorized by its new economic countercoercion toolkit (Jin et al. 2025). At the same time the Ministry of Commerce (2025a), when it added US enterprises to its UEL, accompanied the restrictions with an overarching assurance that “the Chinese government continues to welcome enterprises from all countries to invest and do business in

China, and is committed to providing a stable, fair, and predictable business environment for law-abiding foreign invested enterprises operating in China.”

It is unclear whether these assurances align with the credibility of the threats. Beijing’s use of its new export control tools is clearly credible: the April 2025 controls on rare earths and rare earth magnet exports led to a 76 percent decline in exports, disrupting production for the automotive, aerospace, and semiconductor industries and also threatening the defense sector. Automotive firms in Japan, Europe, and India had to either cut or halt production (Bloomberg News 2025, Shah 2025, Shiraki and Shah 2025, Stockman 2025).

In the face of such disruptions, China’s reassurances about continuing to provide a welcoming business environment risk coming across as cheap talk, unless the government can provide costly signals that demonstrate credibility (Fearon 1997). Indeed, economic data indicate foreign firms’ continued caution about doing business in China. Data from the [State Administration of Foreign Exchange](#) show that foreign direct investment (FDI) into China after April 2025 remained depressed compared to 2020–21 ([figure 6](#)). While this trend likely also includes general risk aversion arising from the enactment of US tariffs, geopolitical tensions, and China’s weak domestic economy, it underscores the challenge that the Chinese government faces in trying to attract FDI.

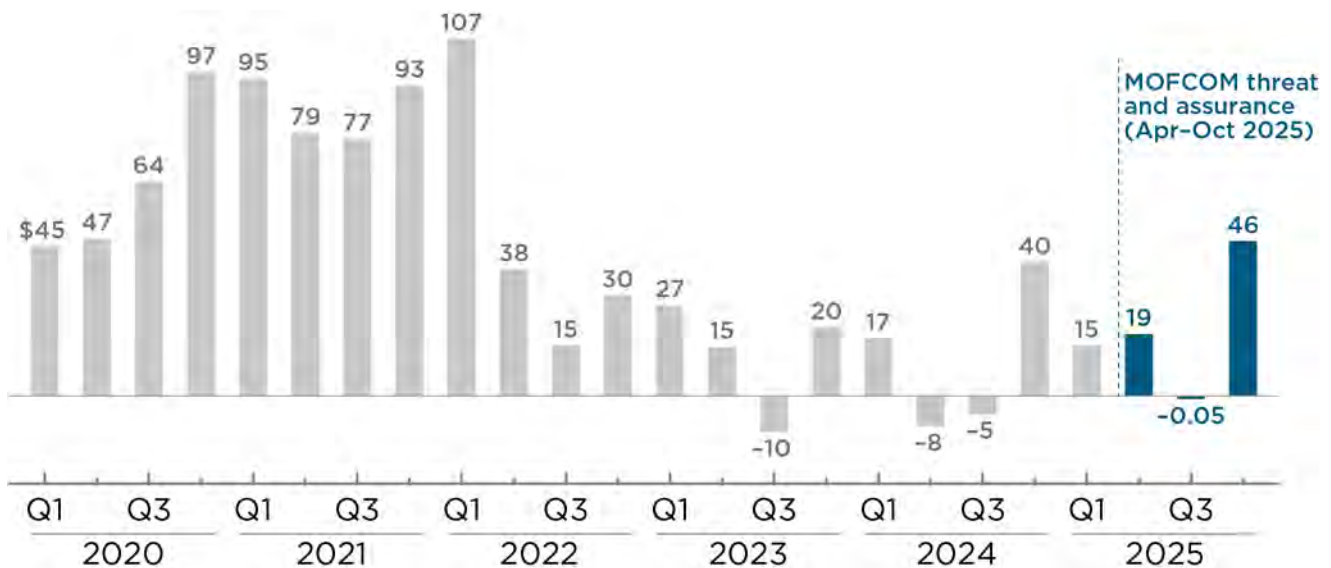
Events between April and October 2025 demonstrated how security dilemma risks play out in economic compared to military realms. The deep interconnectivity of economies via trade, investment, and production networks means that threats to one party can reverberate across supply chains. It becomes difficult, then, to attempt to surgically inflict pain on just one target and not others, and to provide credibility in both threat and assurance. Instead, third parties have found themselves caught in the crosshairs of great power rivalry. Chinese export controls targeted at the United States impacted many third-country economies, including European manufacturers dependent on American components that contained controlled inputs such as rare earth elements and magnets (Banin et al. 2025, Ministry of Commerce 2025b). For these third countries, it would be difficult to justify



China's actions as being defensive against American coercion, given the harm inflicted on their firms.

Figure 6

**Foreign direct investment flows into China, 2020–25 (billions of dollars)**



MOFCOM = Ministry of Commerce of China

Source: [China State Administration of Foreign Exchange](#).

The structure of economic bureaucracy adds another challenge in signaling credibility. China's economic bureaucracy, in spite of operating in a single-party state, faces coordination and implementation challenges (Tan 2021). The opacity of the Chinese party-state apparatus makes it even more difficult to ascertain whether certain outcomes are the result of deliberate intent, lack of coordination, or poor implementation. For example, although short-term deals hammered out between the United States and China in different European cities after April 2025 led China to agree to suspend controls on rare earth and critical mineral exports, firms nevertheless experienced delays in licensing approvals, and these delays generated further tensions and confusion not just in bilateral relations but also between China and European nations. On the one hand, the delays could be due to bureaucratic inexperience or inadequate capacity. The Bureau of Industry, Security, Import

and Export Control, in the Ministry of Commerce (MOFCOM), is a relatively new entity in charge of implementing the Export Control Law passed in 2020. The new licensing approval process was something that firms and MOFCOM agencies at provincial and central levels all had to learn and develop procedures for implementation. On the other hand, the delays could be a signal from China about its control over the flow of vital inputs—and ability to inflict pain on target states as and when it sees fit. It was not clear “whether this reflects the teething troubles of a fragmented bureaucracy dealing with lots of red tape—or deliberate foot dragging” (Arcesati and Junusova 2025).

Absent information that credibly differentiates between intentional reneging and poor execution, decision makers are likely to fall back on existing cognitive frameworks or risk preferences to adjudicate between different explanations for the state of affairs. Whichever the actual reason, it was thus unsurprising that the United States later accused China of having broken the terms of agreement, leading to another round of escalation.

In response to perceived US escalation in September 2025, China launched another round of controls on rare earth elements and associated production equipment and technologies, generating yet more uncertainties. As discussed earlier, these controls contained new extraterritorial conditions which the Ministry of Commerce justified as necessary for reducing diversion and evasion risks (Ministry of Commerce 2025c). While the extraterritorial conditions sought to tighten the credibility of China’s economic countermeasures against the United States, they also affected the economic interests of parties located in third countries.

The result is that, although the measures were primarily retaliatory against the United States, countries in Europe also updated their threat perceptions in light of China’s actions. A 2025 survey by the European Union Chamber of Commerce in China found that about one-third of European firms surveyed were seeking to diversify their sourcing beyond Chinese inputs because of concerns about China’s use of export restrictions (Cash and Baptista 2025). Such data suggest that China’s economic threats are more credible than its assurances about being open for trade and investment.

## Risk Aversion Drives Firm Exit and Weakens Information Channels

Research on the linkages between economic interdependence and conflict indicates that economic ties do more than raise the benefits of peace relative to conflict. Economic interdependence also reduces the risks of conflict by boosting information exchange and reducing uncertainty (Gartzke, Li, and Boehmer 2001). Trade and investment ties give states important information about each other, from specificities about costs that a potential rival is willing to bear domestically in the event of a conflict to strategic intent, resolve, and capabilities. Economic information channels reduce the chances of miscalculation and misperception and thus lower the likelihood of unintended conflict.

The size and complexity of China's economy arguably make the information channel more vital for geopolitical stability. Notwithstanding significant centralization over the past years, local governments in China maintain substantial responsibilities for implementing economic policies on the ground. This means that actual conditions in cities around the country may differ from central guidelines, making assessments about Chinese economic policies and outcomes difficult to get right without close interactions with both firms and local government agencies.

The risk aversion and firm exits that geopolitical tensions have triggered raise the odds of misperception by eroding the quality of information exchange. Evidence suggests that foreign firms are exiting China out of political risk concerns rather than economic calculations, and that those that remain are reducing their footprint in China and/or shifting supply chains to build resilience against policy shocks. The American Chamber of Commerce in China (2025) further reports that US firms face numerous difficulties with getting expatriate staff to relocate to China for work, with "bilateral tensions and other geopolitical concerns" cited as the top concern in both 2023 and 2024. A European Union Chamber of Commerce in China (2024) survey of members similarly found that almost 40 percent of respondents face difficulties with international talent recruitment for their China operations.<sup>14</sup> As the EU Chamber notes,

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14 This reluctance to relocate, of course, is unlikely to be solely driven by geopolitical tensions.

this challenge with talent recruitment weakens ties between the headquarters and Chinese offices of their multinationals, which is then likely to have knock-on effects on the communications between headquarters and country governments. The ability of these governments to then make accurate risk assessments and avoid miscalculation becomes more challenging.

### **Resource Misallocation Leads to Excess Capacity, Driving Perceptions of Malevolent Chinese Intent**

Domestic resource misallocation driven by security-oriented industrial policy may have spillover effects on external relations. As seen in higher-profile cases such as steel and electric vehicles, excess capacity in strategic sectors can intensify trade frictions and reinforce perceptions that China is pursuing dominance for geostrategic gain. This dynamic has also been observed in the Belt and Road Initiative, which, although at least partially driven by excess supply issues domestically, has come to be associated with malign geoeconomic intentions such as “debt trap diplomacy” (Rolland 2017; Freeman 2020; Ni, Lu, and Xue 2021).

The structural features of China’s political economy that lead its manufacturing sector toward excess capacity are likely to be supercharged by economic security logics that make self-reliant innovation a national imperative. If and when excess capacity in innovation-intensive sectors starts to build up in China, a familiar pattern will probably play out. Unlike in steel, however, exports in these sectors are likely to fuel uncertainty regarding China’s strategic intentions. This is because global market share in AI has profound implications for who gets to set international standards and who gains “platform power” outside of home markets (Culpepper and Thelen 2020). The numerous actors involved, from individual Chinese firms to host country governments, and the difficulty of determining whether export surges are driven by the market, by supply-demand mismatches in China, or by geopolitical strategy, further raise the risks of strategic misperception. China therefore faces heightened risks that its high-tech exports will be framed internationally in terms of mercantilism and malign geopolitical intent.

## V. IMPLICATIONS AND POLICY OPTIONS

This paper's focus on analyzing one aspect of the US-China security dilemma (the risks of China's shift to economic security) is not meant to minimize other factors that have driven the change in China's threat perception vis-à-vis the United States, or vice versa. Given that the United States has also leveraged its economic ties with China to coercive ends, the risks of misperception and uncertainty, as well as the resulting credibility gaps, of course run both ways. Mitigating the security dilemma first requires mutual recognition of the ways weaponizing economic interdependence can weaken national security. Based on such recognition, measures might then be adopted to build toward a mutual commitment to risk mitigation. In particular, policies should focus on reducing the sources of misperception and uncertainty that can end up undermining the national interests of each country, leaving all worse off.

Policy solutions need to identify credible assurances that either reduce offense/defense ambiguity or mitigate uncertainty about intent. One set of options is unilateral. These are actions that are aligned with China's national self-interest and could therefore be proactively taken to reduce strategic misunderstandings.

For a start, China could consider enhancing transparency about the procedures and decision making behind its new export control regime. Such transparency would include information on the procedures and stages for different applications, the criteria for approving or denying license applications, which agencies are involved in the decision-making process, and how final decisions are made. Increased disclosure about these processes would mitigate the types of ambiguity that plagued US-China relations in May 2025 over why licensing approvals were delayed and reduce the odds of strategic misperception.

Second, clearer restraints and guidelines are needed about the circumstances under which China would deploy economic force as a countermeasure.<sup>15</sup> The countercoercion toolkit might be described

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15 The European Union's guidelines for authorizing the use of its Anti-Coercion Instrument are one example.

as designed for retaliation rather than first use; as such, some may argue that the tools are not designed for initiating hostilities. That said, the legislative language currently allows broad discretion for the government to define what is or is not considered a hostile act that threatens China's "sovereignty, national security, and development interests." The inclusion of "development interests," in particular, opens up an almost limitless number of acts that might qualify a party for economic countercoercion by China. The buildup of a strong retaliation toolkit may also change China's strategic calculations of its ability to withstand external coercion, leading it to take on more risks than it otherwise would.

Such active restraints on the use of countermeasures would no doubt be politically difficult to adopt. Institutional opacity has long been a feature of Chinese politics. From one perspective, broad legislative language gives China the advantage of strategic ambiguity, so incentives for greater disclosure and stronger guardrails are weak. But this paper highlights the real costs that China bears as a result of such opacity. These costs include assurances that lack credibility with external audiences, heightened uncertainty over China's "true" intentions, and resulting risk aversion and misperception that lead foreign firms and governments to reduce their engagement with China.

Third, China could adopt measures to demonstrate that its policies are not designed with a "beggar-thy-neighbor" logic in mind (Rodrik and Walt 2024)—in other words, to signal that economic benefit to China does not have to be achieved at the cost of others' economic pain or vulnerability. Such measures would reduce the risk of Chinese economic policies being interpreted as predatory in intent. Examples could include actions that fall under managed trade, from voluntary export restraints and price controls to domestic measures that curb excess capacity.

The conditions under which such actions might be taken unilaterally are harder to identify, but history provides examples of countries proactively opting to employ administrative guidance to curb production capacity in select industries. Japan has in the past used recession cartels to structure production capacity cuts in the face of downturns in demand, and used rationalization cartels to improve efficiency (Johnson 1982). In Europe, Article 101(3)

of the Treaty on the Functioning of the European Union likewise allows for administrative guidance to coordinate the reduction of production during times of crisis in order to improve efficiency (Odudu 2006). And China itself regularly uses administrative guidance to curb production, most recently in the electric vehicle industry (Chen 2026).

The question, then, is how such voluntary curbs might be usefully deployed to reduce security dilemma risks. Here, options are stronger in bilateral settings, drawing on multilateral principles. In particular, it might be worth looking to basic principles of the WTO and its predecessor General Agreement on Tariffs and Trade (GATT). The goal is to identify which core international trade principles could be redeployed to mitigate the security dilemma, and which might instead fuel it and should therefore be used with caution.

The current approach to deal with the competitive effects of Chinese exports is to use antidumping or other fair trade investigations. Such measures rest on a WTO principle that protection can be applied where WTO-inconsistent behavior has been identified. However, these principles are likely to exacerbate rather than mitigate security dilemma dynamics, as they require the assignment of blame, which neither party is likely to accept if each views the other as the primary source of security threats.

Instead, it might be more fruitful to look to a different principle, namely GATT Article XIX on safeguards, which recognizes the right to protect in the event of an import surge, regardless of why the surge occurred. The same principle acknowledges a responsibility to compensate exporting countries for the loss of revenue. In practice, when countries fail to agree on a compensation package, an alternative is for both sides to agree on a voluntary export restraint (VER).

One option, then, is to repurpose the principles and practice of this safeguard provision to mitigate the security dilemma. The willingness of either the importing country to offer compensation in exchange for tariffs to slow imports or the exporting country to adopt a VER (which raises prices on the reduced exports) in exchange for not being tariffed serves as credible assurance to the other about the lack of hostile intent. This assurance,



in turn, reduces the risk of both sides escalating their threat assessments of each other.

Another trade principle that could be repurposed would be GATT Article XI:1, which seeks to keep trade flowing by prohibiting nontariff barriers on exports. Although multiple exceptions and carve-outs (including the national security exception) allow for export controls, there are ways in which the fundamental principle can be repurposed. One option is to strengthen the conditions under which the continued flow of specific products will be protected. The WTO's Ministerial Decision on World Food Program Food Purchases Exemptions from Export Prohibitions or Restrictions, adopted at the 12th Ministerial Conference in 2022, is one such example. It commits member states to not imposing export restrictions on foodstuffs purchased by the World Food Program for noncommercial humanitarian purposes. While this decision includes a carve-out for domestic food security threats, it demonstrates how trade rules can be made to affirm and secure the continued flow of goods, as a credible assurance that offsets the growing use of credible threats that restrict such flows.

Principles that strengthen the continued flow of trade can also be repurposed to boost economic security in bilateral relations. For example, the 2026 Singapore–New Zealand Agreement on Trade in Essential Supplies (AOTES) commits both countries to *not* imposing export restrictions on the flow of identified foods, medical products, refined fuel, and construction material in times of crisis. Such agreements might be adapted to provide assurances in US–China relations as well. For instance, both sides could agree on a short list of items that would be exempt from trade restrictions even in a crisis; these could include civilian flights, sports exchanges, academic exchanges in the arts and humanities, or basic humanitarian supplies. While minimal in scope, such positive-list assurances help to limit uncertainties about strategic intent on both sides and could thus have a marginal impact on limiting unintended escalation.

None of these steps would be straightforward to adopt. But these tentative policy options can help address the urgent need for more research and policy attention on ways to mitigate escalatory dynamics in economic weaponization. Dangerous spirals can be

avoided only if closer policy focus is given to the offense/defense ambiguity in using economic tools as strategic weapons and explicit effort is made to reduce the risks of misperception and uncertainty. To this end, basic trading principles that have served the world well in past decades might be repurposed and redesigned to bring greater stability in relations between great powers.

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## APPENDIX

Table A.1

## Top 20 newly approved majors in China, 2020–24

| Major                                            | Total | 2020 | 2021 | 2022 | 2023 | 2024 |
|--------------------------------------------------|-------|------|------|------|------|------|
| Artificial intelligence                          | 406   | 130  | 93   | 57   | 37   | 89   |
| Digital economy                                  | 295   | 24   | 41   | 77   | 79   | 74   |
| Intelligent manufacturing engineering            | 238   | 84   | 52   | 39   | 33   | 30   |
| Big data management and application              | 208   | 59   | 42   | 37   | 32   | 38   |
| Intelligent construction                         | 177   | 23   | 23   | 38   | 45   | 48   |
| Data science and big data technology             | 150   | 61   | 32   | 28   | 20   | 9    |
| Robotics engineering                             | 144   | 53   | 20   | 18   | 23   | 30   |
| Internet and new media                           | 135   | 43   | 24   | 23   | 24   | 21   |
| Financial technology                             | 122   | 38   | 27   | 22   | 18   | 17   |
| Cross-border e-commerce                          | 119   | 42   | 29   | 20   | 13   | 15   |
| Integrated circuit design and integrated systems | 105   | 10   | 25   | 22   | 18   | 30   |
| Energy storage science and engineering           | 102   | 25   | 14   | 23   | 21   | 19   |
| New energy vehicle engineering                   | 92    | 19   | 9    | 19   | 26   | 19   |

table continues

Table A.1 (continued)

| Major                              | Total | 2020 | 2021 | 2022 | 2023 | 2024 |
|------------------------------------|-------|------|------|------|------|------|
| Cybersecurity                      | 89    | 9    | 21   | 16   | 25   | 18   |
| Supply chain management            | 88    | 14   | 16   | 19   | 26   | 13   |
| New energy materials and devices   | 87    | 11   | 12   | 21   | 24   | 19   |
| Digital media art                  | 86    | 27   | 17   | 17   | 12   | 13   |
| Food nutrition and health          | 83    | 13   | 14   | 21   | 19   | 16   |
| Sports training                    | 77    | 7    | 10   | 12   | 31   | 17   |
| New energy science and engineering | 64    | 11   | 6    | 19   | 13   | 15   |

*Source:* Results of undergraduate program filings and approvals for regular higher education institutions (Ministry of Education 2021, 2022, 2023, 2024b, 2025).



Table A.2

**China's legal toolkit for economic countercoercion**

- National Security Law (2015)
  - Measures on Blocking Improper Extraterritorial Application of Foreign Laws and Measures (also known as "Blocking Rules") (2021)
- Foreign Relations Law (2023)
- Anti-Foreign Sanctions Law (2021)
  - Implementing regulations (2025)
- Foreign Investment Law (2019)
- Foreign Trade Law (revised 2025)
  - Provisions for Unreliable Entity List (2020)
  - Catalogue of technologies prohibited or restricted from export (2023 revision)
- Export Control Law (2020)
  - Implementing regulations (2024)
  - Control lists
    - Regulations on dual-use items + list
    - Entity list
- Tariff Law (2024)
- Regulations on Industrial and Supply Chain Security (2026)
- Regulations on Outbound Investment (2026)

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