



International Relations and Defence Committee

Uncorrected oral evidence: The UK's security and trade relationship with China

Wednesday 26 May 2021

10 am

Watch the meeting

Members present: Baroness Anelay of St Johns (The Chair); Lord Alton of Liverpool; Lord Anderson of Swansea; Baroness Blackstone; Lord Boateng; Lord Campbell of Pittenweem; Baroness Fall; Lord Mendelsohn; Baroness Rawlings; Lord Stirrup; Baroness Sugg; Lord Teverson.

Evidence Session No. 13

Virtual Proceeding

Questions 121 - 127

Witnesses

I: Didi Kirsten Tatlow, Senior Fellow, Asia Program at German Council of Foreign Relations (DGAP); Dr Alicia García-Herrero, Senior Fellow, Bruegel.

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Examination of witnesses

Didi Kirsten Tatlow and Dr Alicia García-Herrero.

Q121 The Chair: Good morning. I welcome to this meeting of the International Relations and Defence Select Committee in the House of Lords Dr Alicia García-Herrero, adjunct professor of the department of economics at Hong Kong University of Science and Technology, chief economist for Asia Pacific at Natixis and senior fellow at Bruegel. I also welcome Didi Kirsten Tatlow, senior fellow at the Asia Program of the German Council on Foreign Relations and senior non-resident fellow at Projekt Sinopsis in Prague, Czech Republic.

Thank you very much for joining us today to share your expertise as we continue our evidence-taking sessions for our inquiry into the UK's security and trade relationship with China. As ever, I remind Members and witnesses that this session is on the record, transcribed and broadcast. I also remind Members to declare any relevant interest before asking their questions. If there is any time remaining at the end of the formal run of questions, I shall invite my colleagues to ask supplementaries. Priority will be given to those Members who have not yet had the opportunity to ask questions by that stage.

I shall ask a rather broad question, but I shall then turn to my colleagues who will ask more focused questions. I shall invite Dr Alicia García-Herrero to be the first person to answer my first question.

Last week we heard from one of our witnesses that "our technological tomorrow can often be seen today in China". Do you agree with that statement? What are the relative technological advantages of China? What are the consequences of that for the UK and the wider West?

Dr Alicia García-Herrero: Thank you, Chair. It is a pleasure to share my views with you. I hope you can hear me well.

I will offer a brief answer, given that we have a whole list of questions and I am sure there will be others. The answer for me would be partially yes, especially in three major areas: 5G, artificial intelligence and quantum computing. That is where we can see China's technological progress advancing, although if one looks at the commercial value of these key technologies, the US still stands ahead of China. If we look at the number of companies and their market valuations in, for example, artificial intelligence, there are 15 major companies in China with a value of around \$175 billion. However, there are 24 in the US with a lower valuation. I could go on and on about fintech or 5G, but the idea is that even in those areas where China clearly stands out, it is still not, to me at least, absolutely clear that it is ahead of the United States.

Didi Kirsten Tatlow: Good morning everyone and thank you very much, Chair. I will pick up from what Alicia just said; there are indeed still discrepancies, but China is catching up very fast. That is very clear, and its trajectory is very much upwards. My essential answer to your question

about whether our technological tomorrow can often be seen in China today is: if we are not careful. What we are seeing in China today in terms of technology is a hugely invasive system, which does not just exist in China, but China is founded on very poor concepts of human integrity in a political sense—in terms of human rights and issues like that. There are surveillance issues which are working out very horribly in some places.

There is a lot that we need to do to keep an eye on this. For sure, it is an uneven development, but China's programmes of extracting science and technology, building them up, commercialising them and turning them into money—essentially into businesses in China—mean that it is catching up very fast and there will be a tipping point.

Q122 Lord Boateng: One of the priorities of China's 14th five-year plan is self-reliance. What are the main reasons behind this? Is this simply a return to Mao era sloganeering in the face of "hostile foreign forces", or is it something else? Is it the same as self-sufficiency? What does it mean for China's economic relations with other countries, especially with the United Kingdom?

Dr Alicia García-Herrero: This is a very important question in my opinion. One could argue that this is just going back to Mao, and that would be easy for the rest of the world. Actually, not easy—it would be a pity in a way to see such an economy go backwards, but it is easy to understand. What is happening in China is much more complex.

The concept of dual circulation, which is behind this idea of self-reliance, does not imply that China will close itself to the world. It is more about not being dependent on the rest of the world for technological progress, which basically means that China could, if needed, continue to operate without western technology. That is the inner circulation part of the story: it means "I can serve my consumers by myself if push comes to shove". That does not mean that it will need to do it. Behind this there is the obvious technological war with the US and the push for decoupling in certain sectors or bifurcation as we tend to say today.

However, there is a second part to that dual circulation, which we should not forget. It is that China continues to serve the rest of the world with its exports. That is the difference between what happened in 2008 and dual circulation.

This is because 2008 was really about the world shutting down. We had the global financial crisis and China needed to rely on its consumers. Today is: "I need to avoid dependence on the West to continue to serve both my consumers and external markets". China has no intention—and this is very important—of reducing its market share in the world. In fact, its export share in March 2021 is the highest on record, with over 14% of total exports globally. So, let us not think that China will retrench. China wants to reduce dependence while still exporting to the rest of the world.

Didi Kirsten Tatlow: The dual circulation issue alluded to here is fascinating, in that it is a very novel theory in some ways. It speaks to a sense in China in the Communist Party of how powerful the party sees itself as, because it can move the economy around like that. To me the image is one of a machine in which you have a big wheel turning in one direction and, within that, you perhaps have another wheel turning in a different direction at a different angle. It is a bit like that old game of patting your head and turning on your stomach at the same time.

I think the party very much wants to do both things at the same time. It absolutely wants to continue to supply the world with goods and grow those supply chains. At the end of last year, Xi Jinping said very clearly that China's goal is to increase the world's dependency on Chinese goods. That was a very clear statement.

At the same time, China sees problems coming and wants to take a defensive move, which is this so-called internal circulation issue. That is the second wheel of that particular machine. This mechanistic view is very typical of how the Chinese Communist Party thinks. It has real roots in a scientific, systems engineering tradition, so it sees itself as moving pieces around in a very powerful way, and it clearly has the state capacity to do that. Of course, it is not 100%—humans are humans and there are all kinds of internal conflicts—but it is essentially different from, for example, a democratic or liberal society, or however one wants to describe alternatives.

On self-reliance, we will ultimately be faced with this two-handed action of more of the same growth plus a greater push-back. The key here is that China will seek to involve overseas companies in its domestic economy to indigenise them; that will be part of the domestic aspect. That will not in any way, shape or form release us from the dependency situation which exists in some quarters. If anything, I think it will increase the pressure on foreign companies to indigenise, to hand over technology and, essentially, to become Chinese companies. The IP handover there and the loss of control and power are quite substantial elements; we should think very carefully about what that means for us.

Lord Boateng: Chair, I should declare my interests as chancellor of the University of Greenwich and as a board member of the Syngenta Foundation.

The Chair: Thanks very much, Lord Boateng, you are always very punctilious about that. Can I move on to Lord Stirrup for the next question?

Lord Stirrup: Many thanks, and good morning to both our witnesses. I want to explore the consequences of your previous answers in a little more depth. Could you say a word or two about the impact of the US-China trade war, and indeed of Covid-19, on global value chains? To what degree have they tested the model of integrated supply chains, and what have been the consequences for Europe in general, and for the UK in particular? What lessons, if any, might we be able to draw about the

resilience of our economy in the face of such disruptions, from whatever cause?

Dr Alicia García-Herrero: Again, this is a very important question. We had a draft of a book on China's centrality in the value chain right before Covid. The whole idea was to show that not only was China increasing its share of the global value chain but Europe was reducing its own. However, that was from the highest level of integration; it is clearly still the case that Europe maintains the largest participation in the global value chain. China was basically picking up very fast while we were losing part of that situation, including in the UK.

As we spoke, we also found out something very important for the UK, which is true for the UK and most European economies, except for Germany. We found that there was increasing asymmetry in the relationship between China and the world and, as I said, many European countries, insofar as China was exporting intermediate goods into Europe at speed for us to re-export. This is the concept of the value chain; basically, everything which is imported is then to be re-exported. But we were increasingly reducing our exports of intermediate goods into China for China to re-export, and this is especially true for Germany.

This is a complicated concept, but it brings me to what happened during Covid. I had expected, because we were starting to see signals of a change in this reality, first, that China would gain market share and, secondly, this centrality and asymmetry—that is, it would become more of an exporter of intermediate goods rather than an importer. That is what we have in mind when we think that Germany has benefited so much from China, but the point is that that was happening increasingly less.

So much had been said about reshuffling, and we expected that it would happen during Covid. It has not. That is what the data shows. I cannot put my hand on my heart on this, because we do not yet have input-output data to confirm it. We have only gross trade, meaning that we do not have good data for intermediate goods. But it seems from the gross data that China has gained even more market share generally in intermediate goods and in final goods, partly because the rest of the world was, frankly, having difficulty producing. Of course, many companies were closed. If anything, there has been an increase in that centrality, and certainly an increase in that asymmetry.

So, more than ever, China has provided the world with intermediate goods, substituting the traditional exporters of intermediate goods—namely, in particular, Germany and other parts of Europe. I do not see that reshuffling happening, but I have been writing about why the reshuffling might be needed, not only politically—this is, of course, a very important concept, in terms of resilience and extreme dependence on certain specific goods—but also why that might be the case economically speaking. That relates to environmental reasons, overly long distances in value chains, what that means and so on.

I will stop here, but I end by saying that the reshuffling has not been seen due to Covid. If anything, it is the opposite: there is more of that China centrality in the value chain.

Didi Kirsten Tatlow: Absolutely. I am not an economist by training. My area is more political, technological and ethnographical—I am a Sinologist, if you like. However, it is very clear that, also viewed on the political level, China has in many ways gained ground tremendously during this last year, alongside the trade and value chain issues that Alicia just referred to.

A small example of how that has worked was the experience in January 2020 of going to a pharmacy, trying to find PPE goods—face masks and hand sanitiser—and being told that it was all sold out. I experienced this myself in Germany as early as January because I realised in December what was going on, and I very much feared what was to come. That was partly to do with having gone through SARS-CoV-1, but that is another story. It was all sold out. I then began to research what had happened to this PPE, because nobody in Europe really knew what was coming. Indeed, it was often people of Chinese origin—PRC citizens—who had snapped this stuff up and sent it back because they knew exactly what was going on at home. There we were: we did not have this stuff in Europe and we needed it suddenly. What happened? China used its incredible political system to crush the virus and at the same time push production and—whoomph—it all came back. Europe was suddenly full of PPE again, and China's production soared. It went through the roof. I think this was a very clear gain. In fact, the Congressional Research Service in the US did some very interesting examinations of the policies and directives that went out in Beijing and the localities at this time, in January, February and March, and showed the trade flows and how China benefited enormously from that.

That is one example of the pattern that seems to arise from the enormous political agency that China has and how it can move these chess pieces around the board. To draw this into a political issue, my research shows heavily that this was very much an organised move, as well as being a natural human action; that is, to want to send friends and relatives helpful goods back home. It was also politically organised by various parts of the Chinese Communist Party, such as the United Front. I did the research and you can track who told whom to do what when. It is provable stuff. People take advantage of a good crisis, and I think that is what happened in China last year.

Q123 **Lord Teverson:** We have often contrasted the fortunes of the UK and Germany in relation to China. What are the key features of the political and economic relationship between Beijing and Berlin, and what can the UK learn from that? I remember well, even back in the golden era, Prime Minister Cameron almost being sent to Coventry by China when he met the Dalai Lama, yet when Chancellor Merkel did the same there was hardly any reaction. Why is that? Is it history, better diplomacy, economic dependency, or none of the above?

Dr Alicia García-Herrero: I am sure Didi has much more to add, since she is based in Berlin. I am on the advisory board of MERICS, which, by the way, has been sanctioned by China, but we are still there. I have followed in some detail the economic relations between Germany and China and looked at why countries exporting services, whether financial services, tourism or education, have not really improved their trade deficit with China compared with those exporting intermediate goods, such as Germany. As I said, if China is moving up the ladder, and it has become by far the largest exporter of intermediate goods in the world, you would imagine that those countries that started out by benefiting from China—that is, Germany—should no longer benefit as much, because China is moving towards a model by which, if anything, it needs services more than goods, and certainly more than intermediate goods.

One wonders why that has not happened and the answer is very simple: China has not opened up to services yet. Of course, we have seen some improvement, such as in financial services—a big deal was announced right after Trump's visit to Beijing—and we also know that many US and British but also European financial institutions have been moving into China with control. We all know that China's financial system is too big for anybody to compete. Our role in that massive financial sector will be limited. Just to give a sense of dimension, China's financial sector today, in terms of global surface or global systemically important financial institutions, is the biggest in the world. China's bank assets to GDP are more than 300% of GDP. If we think China is big, its financial sector is much bigger relative to the rest of the world. That is something we need to realise. In that regard, even if China opens up, it has opened up late enough for us not to make a difference.

On tourism and education, and going back to Didi's point about grasping the opportunity of Covid, we are seeing a clear change. For many, this is just a temporary change but, for me, it is a structural change, meaning that I do not think China will ever see the amount of tourism overseas that it saw before Covid. This is partially a move that started before Covid—the idea of "love your country", with domestic tourism being pushed hard. In China, I think it will become the norm, as well as the idea of there being anti-Asian movements in the US and, partially, in the rest of Europe. All that is a signal that China will not allow so much importing of services, whether tourism or education overseas. In that regard, I do not think that the opening up of services will continue beyond what we have seen in respect of the financial sector, which, again, will remain limited because of its sheer size.

That is why I do not think that economies like the UK's or others which are maybe even more dependent on tourism—we think about southern Europe—will have a surplus with China anytime soon. It is not that I believe that such a surplus makes a particular difference, but I do not think China is ready fully to open its economy to services. It also has some cultural dimensions. It is much harder to control than goods in terms of the influence of the country. That is my take on this question.

Didi Kirsten Tatlow: Apropos the Dalai Lama and the Bundeskanzlerin, as we call her here, Frau Merkel, she did of course meet the Dalai Lama early on—I think it was back in 2008, as we all know. She was indeed punished, although differently. Why? It was because there was a lot that China wanted from Germany, and here we get to the issue of manufacturing. Germany still has a lot of manufacturing; it is still a core of the economy. It has never changed away from that, and it gives it a strength that, if I may say so, some people in the UK—for example, friends at Make UK—would like to see more of in the UK too, perhaps particularly now, when things are shifting.

I sat next to a person from China who sometimes acts in an unofficial intermediary role between the Chinese Communist Party and the German Government at events such as Bundestag committee hearings. They said, “In the beginning when she came to power, Angela Merkel rather misunderstood things. For example, she met the Dalai Lama. However, now, we are happy to say that she has changed her mind and has in fact understood that this is not the right way forward in relations with China”. There has been a huge shift by die Bundeskanzlerin, and it is controversial here in Germany. There are a lot of people—I will be blunt—who think it is a sell-out; they do not like it. There are many who do like it because it is good for business. I will leave that values question right there. It is an interesting question.

I do not think that it was just the UK getting hammered; it is just that it took longer in Germany and was a bit more subtle, because Germany perhaps had more to offer at that point. I am talking again about manufacturing. China is very keen for Germany to follow through with deals such as the massive \$10 billion deal for BASF, the biggest chemical company in the world, to set up a manufacturing plant in Zhanjiang, in Guangdong province in the south. I note here that Zhanjiang is also the headquarters of the south China fleet of the People’s Liberation Army Navy. So there is lots to digest in all this.

Briefly, on the issue raised by Alicia about financial services, that is a very interesting area. This happened around 2017, and it has pulled in major financial companies—for example, big finance firms from the US stock market. It is interesting to note, too, that there are preferred companies and trusted companies. They need to behave in a certain way. It remains to be seen whether that will actually serve the interests of the countries where those companies are still headquartered, in terms of the ways in which this is expected. We talk about such things as renminbi-denominated trade, but there are trusted companies that are given certain opportunities. It shapes and changes the behaviour of those companies and therefore the broader socio-political context in which they operate and live, and us at the end of the day.

Germany is perhaps less involved in some fintech—again, we have this manufacturing capability. It is also worth remembering that a lot of this, frankly, is hype. Eight per cent of Germany’s exports go to China—that is all. It is not more. I know there are other issues of manufacturing there,

but when you think about jobs here, that is a very important point. The vast majority of German exports go to the EU, and a lot to the US. So Germany really needs Europe.

Q124 **Baroness Sugg:** That is really fascinating on the Germany-China relationship. Moving on to the broader EU-China relationship, it would be good to hear your assessment of the Comprehensive Agreement on Investment between the EU and China and whether you think it will be ratified. Looking at that agreement, are there any elements of it that you think should be replicated for the UK-China relationship?

Didi Kirsten Tatlow: I will be frank; I have published on this, so I see no reason not to be. I have been a critic of CAI, the Comprehensive Agreement on Investment, and indeed some of its inherent contradictions and difficulties have very much come to light now. It has been a bit of a car crash in that sense because the European Parliament has said “Nope, we are not playing along with this. There are too many problems with it.” I am concerned that within Europe it will be a divisive force because of the way that it prioritised the German-French relationship—the axis that is the origin of the EU and the coal and steel agreement. Even other countries have other concerns very much on the fringe, although they did not on the official level oppose this outright, and probably did not want to either.

I thought the timing of CAI was bad. There was the whole issue of a deepening relationship and dependency at a point in history where we did not even know what was going on with Covid. We still do not know what Covid is or where it came from. To plunge headlong into a treaty—sorry, not a treaty, but something below a free trade agreement; just a trade and investment agreement, I suppose—at a point when there were so many open questions seemed to many people, including me, to be foolhardy.

So I have to be frank and say that I do not think there is anything the UK can really learn from this. Alicia may have more to say on the technical economic details. There are aspects of CAI that are interesting, such as the issue of how its agreements should apply more widely in the world—there is the perennial issue of how we get China to open up more, because it is not a free economy and it does not do free trade—and the level playing field. These are laudable issues but they need to be real and not leveraged by China, which is what we have seen for years. I will leave my CAI comments there and hope for good in future.

Dr Alicia García-Herrero: This is a topic very close to my heart, and I have written about it. I want to share the views of other colleagues from Bruegel because they did a very thorough analysis of CAI from a different perspective. It is relevant because it is more positive. There may be some lessons to learn for the UK and, more importantly, for the potential reform of the WTO. This is really about certain concessions that China gave in the phase 1 deal, such as technological transfer and a little bit on subsidies, although there is much more on that within CAI, such as the transparency of subsidies. Now, if a European company were to claim

that market access in China was hampered by state subsidies to companies there, it could actually go to a state-to-state dispute settlement to get the information on those subsidies. In other words, that company could finally have information relevant for it to act—through the WTO if it was a manufacturing company, or for service companies, which are discrete from the regulations on subsidies at the WTO, through CAI.

That is just one example and there are others, such as on SOEs, state-owned enterprises. So there are some valuable propositions in CAI, mainly on transparency, that are not yet embedded in our framework at the WTO with regard to China. One could argue that that is good news, but the reality is that the EU—at least, this is my humble opinion—was not negotiating CAI to improve China's transparency as opposed to the rest of the world. It was very generous of the EU, if I may say so, but this is a bilateral investment agreement so what really matters to me as an economist are how much market access, how much reciprocity and how much more of a level playing field you obtained out of CAI. These are the three key issues.

On reciprocity, and you can check this, the word is not even mentioned in CAI, not once—because there is no such thing as reciprocity. Now you will hear comments by the European Union Chamber of Commerce in Beijing that reciprocity is not a concept that we should use any more because it would only mean that the EU became more closed rather than more open in order to bring us to the same level of operations with China. Well, maybe, but we have been claiming that we wanted reciprocity for so long that changing our view right before signing CAI looks a bit strange to me.

On the level playing field, as I mentioned, there has been an improvement but that is mostly because of the unilateral decision taken by China to approve its foreign investment law, by which China still keeps 33 sectors closed to control by foreign companies—these include the telecoms sector and a whole clutch of sectors that are still very relevant—so we did not go beyond that.

Bilaterally, the EU got electric vehicles, where the investment has to be above €1 billion. This brings me to Didi's point: given the size of a company in the electric vehicle space in the EU, €1 billion is a big investment. These are not like traditional vehicles, which means, for example, that the dependence on Chinese batteries for that sector will only increase, so in a way you are moving your ecosystem east. That is very important for a new sector. It would not be the case for transitional vehicles, where we did not get any further market access because it is supposedly at excess capacity.

The EU also got hospitals in eight major cities, but the small print of the agreement says that these should be mainly run by Chinese citizens, so it is not like a fully-fledged control operation. Most other sectors cannot be controlled, as I said: in telecoms and the cloud, the figure is below 50%. So there is not really a major push in market access.

In a nutshell, I am not saying that there is nothing to learn but CAI is not a major breakthrough in EU-China relations—first, because it is only investment and there is no trade involved, and, secondly, because the market access, beyond what is offered to the rest of the world, is limited to electric vehicles and hospitals in eight major cities. It is meant to be a game-changer but it is not.

Q125 Lord Mendelsohn: Thank you to the witnesses for their trenchant comments so far. It was suggested that one of the attributes of CAI was that it advanced protection over forced technology transfer and IP disclosures. I am pushing you to look more at the UK. What are the issues or potential threats that we are concerned about with Chinese technology transfer policy regarding the UK? I would be grateful for your thoughts on that. What are the particular challenges for UK universities and research institutes? What protections will be necessary to create an opportunity in technology co-operation with China?

Didi Kirsten Tatlow: My first comment relates back to the last question you raised on CAI about forced technology transfer. Forced technology transfer is also something called trade for tech, whereby you say, “here is the tech, now we want the manufacturing and trade”. In our estimation, in a book we published last September, it is only one of 32 methods whereby technology exits the world and goes to China. China identifies spots and transfers technology back to China. There are 32 ways this is done; a mixture of legal, illegal and grey-zone methods.

The trade for tech that CAI addressed is just one of the 32 ways whereby China is trying to build itself up technologically by extracting IP research from overseas to strengthen its own economy and rise in the world to become the world leader in all areas by 2049, which is the avowed, stated goal of the Chinese Communist Party. That is not just economic; it is everything, really. That is quite a thought. It is worth pausing there for a second to think about what that actually means, not just for us but for our children and our grandchildren.

On technology, I have researched this very deeply and for decades we have viewed China almost as an object of development: a place in need of more technology to grow richer, feed its people, create an economy and so on. That is all true and it was the way in which people went to China to do business, as well as, of course, with a very healthy self interest in mind. However, that could continue beyond a point where it hurts our own societies and economies, which are, as democratic societies, hard to maintain. Democracy is not an easy thing, it is a process, not an end goal and it costs a lot to maintain democracies; they are troublesome, quarrelsome paces. They are also very free and highly creative, which is, of course, the trade-off.

At some point there will be a tipping point. I think we are very much approaching that, in the sense that things have now gone far enough, and we need to rethink. So, how do we do that? First, we need to be very clear. It is about knowing exactly what China is doing in technological, economic and other related areas by extracting knowledge and

information, bringing it back to China, then deploying and commercialising it in China. We need to do a lot of due diligence in universities, in what our diplomats are doing, and in what science and technology diplomats in Chinese embassies are doing.

For example, there are at least 52 embassies or consulates around the world where Chinese science and technology diplomats are stationed. They routinely scout, spot and transfer back hundreds of business ideas, details, programmes and projects to China. These then get commercialised through a vast network of technology transfer parks or overseas returnee parks. It is really an incredible industrial policy, and certainly the most efficient and best science and technology transfer policy in human history, so we need to get to the bottom of that. Thankfully, we are approaching the point where we understand what is happening pretty well. The trouble is that it remains in a specific specialist sphere and has not gone into general knowledge in government or education and institutions, and that is the next leap we need to make. The knowledge is there.

Apropos what to do, we need to scan much more carefully. Here I am going to say something controversial, but so be it: we need to look very carefully at the role of the Communist Party in our universities, businesses and societies. That is because anyone who is a member of the Chinese Communist Party is subject to party discipline, when they are, for example, researching in the UK. That is potentially a very severe thing, and they are always available to pressure, persuasion, profit, or a combination of all those, to fulfil the goals the party puts out for them and requires back in China. So, one thing we need to think about doing is asking people to declare if they are members of the Chinese Communist Party and thinking through the consequences of having those people within our universities, research structures, businesses and so on. Of course, people may answer "No, I'm not" and they may lie, but then they would have lied, and that matters. We need to start tracking this. That would be just one way to begin to deal with the problem in research and universities.

In other ways, of course, we need to fund research, universities and education at all levels far more. China does that because it really understands the value of education; indeed, it worships education. That is a cultural trait and, in my opinion, a very impressive one. We need to do that too; we need to invest. We cannot leave this up to businesses alone because they are subject to pressures. That would be one small way of answering that question. It is a huge stand-alone issue, and I want to make sure Alicia has some time to answer too.

The Chair: I have had a note from Lord Mendelsohn, who wishes to declare an interest, and slightly slipped up in not doing it earlier.

Lord Mendelsohn: My apologies, I declare my interest as a senior adviser to Value Retail PLC.

Dr Alicia García-Herrero: I am going to look at this from two angles. First, I am going to be very narrow to the question of technological transfer and perhaps one of the 32 different aspects Didi studied in her book. My answer is going to be much drier and more precise, but because the question was related to CAI, I will try to focus on that specifically.

CAI contains an obligation for the parties not to impose or enforce, the key word being “enforce”, any requirement or undertaking to transfer technology. The language used in CAI is stronger than in the phase 1 deal. I want to insist on this because one of my colleagues at Bruegel, André Sapir, has just written and published a book on China and the WTO and how we should reform the WTO. His words together with Petros C. Mavroidis—I do not want to forget the second author—make a strong point that the word “enforce” is key to narrowing down or being sure that technological transfer cannot be enforced in China or any other country in the world.

This statement in CAI includes joint ventures. Therefore, it is not only for wholly owned entities or foreign entities in China, but also for joint ventures, so it is rather powerful.

However, I cannot agree that this is only one way, as Didi said, to control technological transfer. One thinks of the many indirect pressures: the waives to market access or having licences approved in a different region or province, which could make this much more self-censoring. In other words, a company may not be willing to declare that there has been such thing as a forced technological transfer, than this case in point.

This is just a narrow point of view on that question. I want to add to Didi's comments, which were very interesting. I would not say that this is a substitute, but it certainly is a complement to her suggestion. I am a believer in us—that is, Europeans and westerners in general—actually doing what the Chinese do in the West, though perhaps differently. Why do we not have more students going to China to learn, especially in the technological field? Why do we not have them learn those technologies that we have said are very advanced in China? Is that not possible?

Say I have a PhD student in quantum computing. Can that person access the same degree? Would that person have the same access a Chinese student would have in the West? I would go about it in terms of reciprocity rather than scrutiny only. That would be more engaging and perhaps eventually it would be less easily criticised from the Chinese side—perhaps alongside, frankly speaking, many problems. This brings me to climate change and other issues on which I think co-operation is unavoidable and much more fruitful. I think we should explore that path—that is, knowing more about technological progress through our own students being located in China.

Q126 **Baroness Fall:** Good morning. I declare my interest as a senior adviser at Brunswick Group. We have spent a lot of time talking about areas of conflict with China and the West, but, of course, co-operation is needed to address the vital issue of climate change. First, to what extent and

how do you think climate change is viewed within China, including in terms of policy? Where is there a possibility for alignment with the West coming into COP 26 later this year?

Didi Kirsten Tatlow: The line dropped a little bit for me during the first part of that question, but I do not know if that was me or the other side.

If I may, I would like to very briefly respond to what Alicia said, because there might be a slight misconception there. The one way Alicia mentioned is among 32 ways: there are all kinds of things happening, and this narrow definition of trade for tech is simply one of many. The 31 others include many other things, some of which she mentioned there. It is not just one stand-alone thing. It is a whole spectrum, and that is how we need to think about technology transfer—mostly unwanted technology transfer—from the West to China and a system of doing that, which has existed in China since 1949 and in great strength since 1956.

I apologise, but this is a very important point: on students going to China, the trouble is that Chinese law will largely prevent the sharing of knowledge back into the West. We have really draconian data security laws coming up. We have cyber sovereignty laws and national intelligence laws, all of which forbid all kinds of activities by foreigners in China. We have very stringent counterespionage laws in China. This is in no way, shape or form a free or open society. While in theory it sounds right and good to say that foreign students should go there and learn, for example, about quantum mechanics—which, of course, was taken originally from Europe in the first place; this transfer process is documented—and then pursue it in China, the reality is that the Chinese education system is simply not open. It is run by the party. The communist party maintains control over the entire Chinese education system, from primary to postgraduate. That is simply a fact. Again, we are dealing with and are up against a political issue. That seems to be how it works. I know many people who have done MAs, PhDs and undergraduate degrees in China, and their stories all tend to be the same: at some point, their knowledge gets transferred and the person who benefits tends to be on the Chinese side.

My apologies: I will get back to the question at hand on climate change. Again, I am sorry to be the more sceptical analyst here, but when it comes to climate change we need to be very careful that it is not leveraged by the Chinese Government in order to position themselves to get hold of technology, such as clean energy technologies, in order to manufacture them in China. They will argue that they can do this at greater scale, which is probably true. We need to get into a more competitive mindset when it comes to climate change and less of a co-operative mindset, while remaining highly co-operative and open to co-operation. We must not forget that there is a lot that we can do—for example, in the UK, Germany the US and New Zealand, or all together—to create wonderful solutions based on science and technology, as well as social, political and human values, to deal with climate change. We really need to go completely full speed ahead on that. China will be obliged to compete because it is also very threatened by climate change. It has a lot

of low-lying land and a lot of people living near the coasts. That is going to be a very robust way forward, but it is a necessary one.

Dr Alicia García-Herrero: This is a key question. Along with the pandemic, this is the most obvious area of co-operation with China. In a way, we supposedly have no choice but to co-operate because the numbers are clear: China accounts for 30% of global emissions, and Asia as a whole accounts for 60% of emissions. On top of that, the main reason that Asia—mainly China and India—is at the centre of global emissions is electricity generation through coal. Literally 65% of total electricity generation in China comes from coal, and it is over 70% in India.

If you think about it, is it a global problem? I am just trying to think a little bit outside the box. To make it very simple, China and India's fossil fuel subsidies are \$30 billion a year—that is the data we have, but it could be much more than that—compared to \$5 billion for renewables. In other words, this is not about carbon pricing, and our estimate is that it should cost about \$45 billion for China to reach carbon neutrality in 2060, as announced by President Xi. It is not that it will cost \$45 billion; it is actually negative, because of those huge annual subsidies. We also have the massive increase in fossil fuel energy in the energy baskets of many countries in the Belt and Road Initiative because of the massive construction of coal electricity generation plants in those countries.

In other words, whose problem is this? We can co-operate, but we need to realise where we are. Does China need help to import technology to solve this problem? Maybe, but China is actually the largest exporter of solar panels in the world. To me, it is not so much about needing help but taking action—it is as simple as that. I would just leave the subsidies and I would stop financing coal plants around the world. As we know, this is by far one of the largest aspects that the policy banks are financing in the Belt and Road geographies.

Co-operation needs to come as a sign of good will once we realise that this is not happening anymore. I see from EU trade policy that we should not necessarily put that baggage on our shoulders and say, "Okay, I can give you market access if you do this on the climate change front", because that makes it seem as if it were our problem, for which we need to pay. I see it more as somebody else's problem on which they need to take action. That does not mean not co-operating; it means supporting where things really are.

Those are the numbers I wanted to share with you.

The Chair: Thank you very much. Time is always an enemy of interesting sessions. I am going to go to Lord Anderson for the last question, even though I know we have only one or two minutes left.

Q127 **Lord Anderson of Swansea:** If you were advising our Government directly, what action would you propose they should take on economic co-operation and tech policy towards China? For example, should

reciprocity be a relevant principle? What safeguards should we seek? I think of the recent example of a semiconductor firm in Newport, which was gradually, step by step, taken over by China.

Didi Kirsten Tatlow: The reciprocity issue is fundamental. Why? It is because China likes to talk about mutual respect in international relations, trade and so on, and reciprocity is essentially mutual respect. We need to negotiate what that will eventually mean, but where there is clearly no reciprocity, as there is not with China, we need to change the formula that we have been following until now in order to create that or find alternatives if it is not creatable. So reciprocity is fundamental. I know it is difficult and people have shied away from it from a long time, but I do not think that we are in a position any longer to shy away from it accepting its importance.

In terms of UK Government actions today, economic co-operation and tech policy, I will quote from the book that we published in September: "Effective measures to manage China's technology predations presuppose a realignment in national policies toward China in general, reflecting that country's status"—under the CCP—"as a technologically advanced nation and strategic competitor, not a 'developing' country in need of a boost and certainly not a cooperating partner in a global order of liberal nations".

That is strong and direct stuff, I think. It is absolutely accurate and the conclusion that we need to draw from it is that the UK Government and other Governments in liberal democracies and open societies need to keep hold of their IP. We need to be very aware of what is happening to our IP. We need to play this game in a much more offensive way, realising that we need to play to our strengths and advantages, and just be a lot tougher in general about what is going on. The old days of Mr Nice Guy, if you like, are kind of over, because there has been a lot of exploitation going on, particularly in the area of IP. That is my advice.

It is also very important to note—I know we are running over time, and I apologise—that the UK Government have policies that say on the one hand that we need to be more careful and do what I have just been describing, while saying on the other hand, "Here's a young, promising start-up company. Go and invest in China". That is a fundamental contradiction. It would be wonderful to see more of that investment taking place in the UK or elsewhere in Europe or in politically friendly, like-minded countries.

Dr Alicia García-Herrero: I will be brief in the interests of time. I would start from a different perspective, which is that China will be the largest economy in the world and there is no way we can stop that. That does not mean that we should accept it without conditions. It basically means that we should do our best to engage—"engage" may be an old-fashioned word now—or, rather, to shape to the best of our ability the China that we would like to deal with.

I know that is very difficult. I agree with the point about reciprocity, but we should also think of concepts that are perhaps slightly nearer to us, especially the European model of more social capitalism, than the ones we have had, such as the Washington consensus type or extreme capitalism type of ideas—bringing us closer to what is happening in China and bringing China closer to us.

One concept that we have worked on is competitive neutrality. Again, this is not about our market but about the Chinese market. If the Chinese market does not work in a more competitive way that allows us to operate there—this brings me to the students, and I know that the laws are against us, and increasingly so, as Didi said—and if we cannot influence China to change that and to open itself up to us, the battle will be lost because we will be in a cold war and we will be increasingly smaller compared to China.

We may be too late for this, but perhaps we can try to open China's eyes to the fact that the world will be very hostile otherwise, given what Didi said, and that is not in China's interests either, no matter how big it gets. It will still be big, but it will be increasingly isolated. Is that what Chinese people really want to see?

I am suggesting a stick and carrot approach in which we envisage how good it would be if we could co-operate, and if we could bring China to our model. I know that it might be too late for us to sell our model, but what about something in between? We have a little bit of a socialist model in the welfare state. China lacks a welfare state. China really has state capitalism that produces goods and services rather than serves its citizens. What about its citizens realising how nice it would be for them to be served by the state in terms of offering pension and free health and education in exchange for taxes.

Can we go through that and show what we really are, rather than just closing ourselves off and seeing the risk coming and fearing it? I do not think that will work. China is already too big for that. Those are my last words.

The Chair: Thank you very much indeed to both our witnesses for some challenging ideas this morning. It has been a fascinating session.