

EU-U.S. CONVERGENCE ON CHINA CHIP SANCTIONS: ON BRITTLE GROUND?

Johannes Nordin

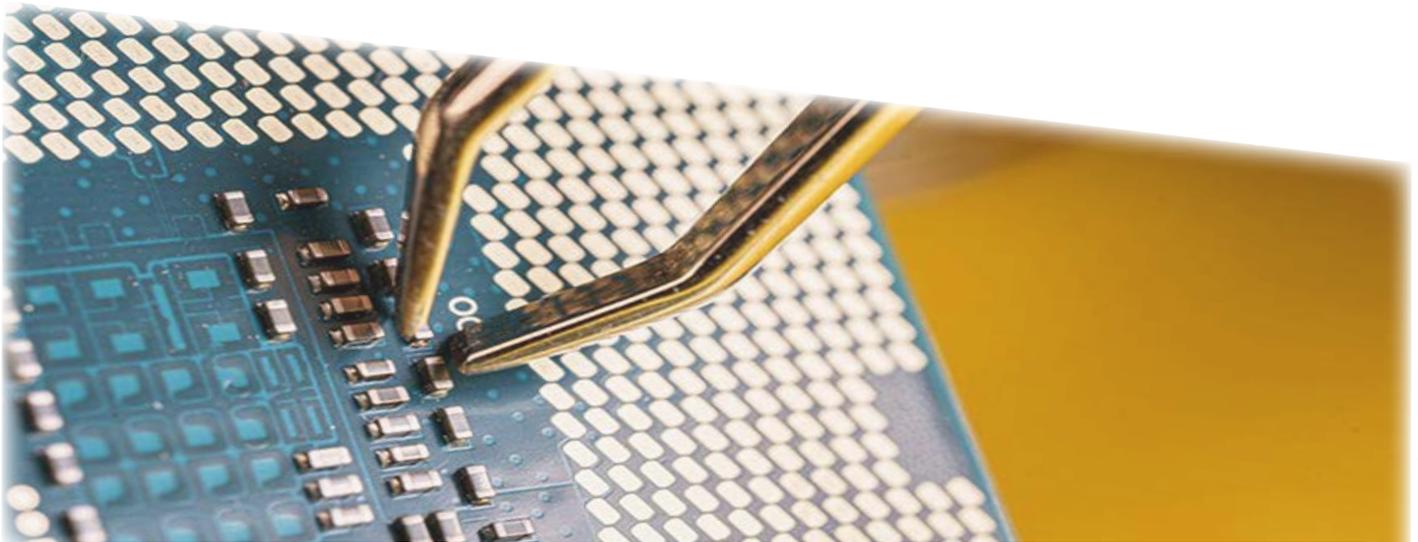


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The United States unveiled new wide-ranging restrictions on China's semiconductor industry in October 2022, unprecedented in scope and intent. Abandoning the Trump years' erratic approach to individual Chinese tech companies, the Biden administration comprehensively targeted the entire semiconductor supply chain, including allied exports. Not only did the sanctions cut off access to advanced components containing U.S. technologies, they also sought to end China's access to the manufacturing equipment needed to produce such components in the first place. The European Union has since sought to find a balance in the new Sino-American tech war, culminating in the EU's Economic Security Strategy of June 2023. This issue brief examines the motivations and impacts of the U.S. chips sanctions and how they have impacted transatlantic relations and European semiconductor priorities.

The U.S. 'Small Yard, High Fence' Pivot

The chain of events towards a regulatory clampdown was outwardly set in motion in August 2022 with the passing of the U.S. CHIPS and Science Act, Washington's new semiconductor strategy—explicitly invoked to counter China. Providing \$52.7 billion for research, manufacturing, and development in U.S. chip leadership, the Act included provisions simultaneously barring funding recipients from building “certain facilities in China.”¹ The same month, the Department of Commerce expanded the scope of the so-called entity list of trade restrictions to include chip-

manufacturing design software, for which U.S. companies hold a 46 percent global market share,² instructing American chip design giants Nvidia and AMD to entirely stop supplying Chinese buyers with certain high-end graphics processing units (GPUs).³ Finally, in mid-October, came the all-out sanctions volley on China's entire chip sector, encapsulated within a 139-page framework of new export administration regulations (EARs).⁴

Made public alongside the new U.S. National Security Strategy, the new export restrictions signaled a change in approach.⁵ Rather than seeking

to outpace China’s technological development and wielding the threat of future chip export restrictions as a source of political leverage, the Biden administration pivoted to broadly suppressing China’s advancements. Using a ‘small yard, high fence’ approach, National Security Advisor Jake Sullivan stressed Washington needed to take control of chokepoints for foundational technologies to keep strategic competitors out.⁶ At a later press conference, Secretary of State Anthony Blinken described the moment as a historic “inflection point,” where the “post-Cold War world ha[d] come to an end, [with] intense competition underway to shape what’s next. And at the heart of that competition is technology.”⁷

As Sullivan had recently emphasized at the Global Emerging Technology Summit, it was no longer enough “to stay only a couple of generations ahead” of the competition with a so-called “sliding scale” approach. Instead, the new strategic environment and foundational nature of certain technologies necessitated “as large of a [U.S.] lead as possible.”⁸ This approach, the Sullivan Tech Doctrine,⁹ is the ultimate end-product of the 2018 Export Control Reform Act (ECRA), which sought to define and prohibit the export of all emerging and foundational technologies with potential dual-use capabilities.¹⁰ This understanding reflects a broad interpretation of national security and effectively a zero-sum view of competition, wherein even predominantly civilian technologies must be restricted due to their indirect implications for military use.¹¹

The Why Factor

Framed through the Trump administration’s ‘Great Power Competition’ lens, Washington’s apprehensions about Beijing’s technological advancements first proliferated in 2018 on the sidelines of the U.S.-China Trade War.¹² The laundry list of complaints with specific tech companies initially centered on alleged industrial espionage and poaching of foreign engineers.¹³ However, it soon morphed into wider concerns that civil-to-government sector technological linkages would

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allow the PLA to leapfrog U.S. military power, with White House rhetoric invoking Beijing’s aspirations to integrate military and civilian technologies through Military-Civil Fusion (MCF) and become a world-leading AI power by 2030.¹⁴ The Trump administration addressed these anxieties by targeting Chinese tech companies with alleged government links, such as Huawei Technologies Co Ltd, adding them to the U.S. Department of Commerce’s Bureau of Industry and Security (BIS) administered Entity List of trade restrictions.¹⁵

Biden’s Department of Commerce had already in 2021 added seven additional “supercomputing entities” to the export restrictions list for their purported support of China’s military modernization.¹⁶ However, even as China’s decade-long chip indigenization push began to evidence major internal issues, including underwhelming progress and rife corruption, the unease on Capitol Hill only intensified amid increasingly distrustful bilateral relations.¹⁷ In June 2022, the Center for Security and Emerging Technology found that the People’s Liberation Army (PLA) had employed AI chips using U.S. semiconductor designs.¹⁸ Meanwhile, a stream of news stories out of China hinted at continued technological breakthroughs despite U.S. sanctions—tales that hardliners on

both sides of the Pacific had reason to embellish. In a first for a Chinese company, Biren—a start-up founded by former Nvidia engineers—designed a 7-nanometer (nm) chip for a general-purpose GPU.¹⁹ Meanwhile, sanction-laden Huawei was filing patents for a quantum computer AI Chip.²⁰ Yet, most notable was the advancements by China’s flagship chip manufacturer, Semiconductor Manufacturing International Corporation (SMIC).

Despite being cut off from the most advanced extreme ultraviolet lithography (EUV) equipment since 2019, SMIC demonstrated the capability of producing a 7-nm chip using older deep ultraviolet (DUV) lithography. Seven nm is the equivalent of high-end chips made by industry leader Taiwan Semiconductor Manufacturing Corporation (TSMC) in 2018, meaning SMIC was still four years and two semiconductor node generations behind the curve. Moreover, demonstrating that something is physically possible to manufacture is quite different from showcasing that it is commercially viable at a more expansive scale. Nevertheless, the news showed a smaller capability gap than formerly believed.²¹ Adding SMIC to the entity list in 2020 had explicitly sought to prevent capability advancements below 10 nm.²²

Despite China’s concerted effort to build up a domestic chip industry, self-reliance has remained a distant target, with only around 20 percent of chip demand sourced domestically. To make up this shortfall, Beijing imported \$415 billion worth of semiconductors in 2022, more than it spent on crude oil imports.

The Biden administration had been courting key partners for some time, following recommendations of the U.S. National Security Commission on AI in 2021, which had called for the U.S., Japan, and the Netherlands to establish a “policy of presumptive denial of export licenses” for advanced semiconductor manufacturing equipment.²³ In March 2022, news emerged about a U.S. push for a potential chip partnership with South Korea, Taiwan, and Japan.²⁴ In May, the second EU-U.S. Trade and Technology Council (TTC) included language on shared semiconductor supply chain security concerns. Nevertheless, there was palpable weariness that Washington’s sweeping national security invocations could excessively harm competitiveness and impair trade relations with China, which alone accounted for 29 percent of the global chip manufacturing equipment market.²⁵ Despite China’s concerted effort to build up a domestic chip industry, self-reliance has remained a distant target, with only around 20 percent of chip demand sourced domestically.²⁶ To make up this shortfall, Beijing imported \$415 billion worth of semiconductors in 2022, more than it spent on crude oil imports.²⁷

The White House ultimately proceeded unilaterally on October 7, simultaneously adding 31 additional companies to the entity list. The new restrictions sought to strangle China’s access to foreign AI and high-end chips, chip design and manufacturing equipment containing U.S. components (including software updates, spare parts, and support), and the tools needed to produce said equipment.²⁸ In addition, the restrictions introduced a blanket ban on all U.S. citizens, whether working in the U.S. or abroad, from participating in projects involving Chinese entities. These measures target key chokepoints in China’s strategic import dependencies, and crucially, they target not only U.S. entities but also foreign companies using American input technologies.²⁹ Unthinkable for many industry observers except in a state of war only a few years ago, the sanctions’ sheer magnitude and explicitness have generated many comparisons to outright economic warfare.³⁰

Initial Impacts

Though the export restrictions would never entirely halt China's technological development, industry experts largely concur they will make it much more expensive, slow, and cumbersome.³¹ Even before the sanctions' compounding pressures, a record number of Chinese chip firms had been going out of business amid a larger industry downturn. China led the global chip tumble, with imports of chip-making machines falling drastically in the last quarter.³² In the first five months of 2023, China's chip imports saw a steep 19.6 percent decline, the first such drop in nearly two decades.³³

President Xi Jinping gathered domestic chip industry leaders for emergency meetings during the 20th National Congress in October,³⁴ yet had limited means of immediate retaliation, as further restrictions on chip trade risked harming China as much or more than the U.S.³⁵ Chinese officials have labeled the expansive national security interpretation an abuse of export controls to maintain "technological hegemony" and have since opened a legal dispute through the WTO.³⁶ Meanwhile, diplomatic efforts prioritized countering U.S. efforts to multilateralize the export restrictions with intensified engagement with the Netherlands, South Korea, and Japan. For instance, at the November G20 Summit, Xi invited Dutch Prime Minister Mark Rutte to visit Beijing, stressing the need to "cooperate with rather than 'decouple' from one another."³⁷ In December, then-Foreign Minister Wang Yi communicated to his South Korean counterpart that the U.S. Chips Act would hurt both China and South Korea, with Wang's successor, Qin Gang, conveying similar sentiments to Tokyo and Amsterdam in April 2023.³⁸

Under a new plan unveiled at the 2023 Two Sessions, the Ministry of Science and Technology will be overhauled to place technology and science initiatives directly under the centralized supervision of the Party. Authorities have also doubled down on financial support to the embattled chip industry, pledging further tax breaks and state support to a select few national champions, as well as new

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chip training bases to address China's chip talent shortfall.³⁹ In a sign of how far Sino-U.S. relations had plunged, Xi explicitly accused the U.S. of “all-round containment, encirclement and suppression of China,” shedding the previously indirect language commonly used when alluding to “certain countries.”⁴⁰

The U.S. sanctions are undoubtedly disruptive, but there is also disagreement among industry experts on their appropriateness and long-term effectiveness. Some critics see the October measures as a group-think-fueled overreaction that has exacerbated tensions with Beijing and allies alike, resulting from exaggerated national security invocations that overlook how most semiconductor uses are ultimately civilian and benign.⁴¹ In the U.S., the measures have contributed to multi-billion-dollar export and job losses, disrupting a virtuous export-financed innovation cycle that long upheld U.S. technological leadership.⁴² Meanwhile, they align the previously conflicting interests of Chinese corporations and the Central authorities. Where many Chinese tech giants in the past might have preferred more efficient imported U.S.-proprietary semiconductors over second-tier domestic options, they now have no choice but to go all-in on the government's self-sufficiency drive.⁴³ In sum, while holding China's chip advancements back in the

short term, the restrictions could speed up the overall process toward a fully indigenous chips sector in the longer run while risking reciprocal countermeasures.

Though Chinese authorities have been mostly restrained thus far, early steps towards retaliatory measures in other trade and investment areas have slowly materialized. For instance, state regulators appear to have slowed reviews of mergers involving U.S. companies.⁴⁴ China's Cyberspace Administration has banned U.S. memory chip giant Micron in key infrastructure for posing "serious network security risks."⁴⁵ Meanwhile, export controls have already been expanded to rare earth materials, sending a warning signal against escalation.

After the U.S. Department of Commerce signaled chip export prohibitions would be tightened further, amid parallel efforts to restrict outbound investments into China's tech sector,⁴⁶ its PRC counterpart on July 3 announced new export controls on several vital metals used in semiconductor manufacturing.⁴⁷ These controls are nominally country neutral and do not by themselves amount to de facto export restrictions. Foreign Ministry Spokesperson Wang Wenbin emphasized the materials in question had dual-use capabilities and that China, like EU member-states, aimed to ensure their lawful utilization.⁴⁸ However, former Vice-minister of Commerce Wei Jianguo explicitly linked the controls to Washington's

escalating technology restrictions, warning they were just the beginning.⁴⁹ Given the emphasis on dual-use capabilities, one could envision an escalating scenario wherein U.S. export restrictions on PLA-linked companies are reciprocated with countermeasures targeting Silicon Valley companies supporting the U.S. Military-Industrial Complex.⁵⁰

China alone produces 68 percent and 98 percent of the global output of Germanium and Gallium, respectively, whose usage extends beyond chip manufacturing to electric vehicles, photovoltaic cells, and batteries.⁵¹ Although they can be mined outside China, it is a costly and time-consuming low-margin industry. Restricting exports and driving up prices would speed up trade diversification away from Chinese rare-earth supply chains but would inevitably come at an interim cost, signaling a readiness to target additional precious metals. More importantly, the PRC authorities are considering the expansion of export controls to processing technologies, restricting or outright banning "exports of technology to process and refine rare-earth elements."⁵² By implementing such a measure, Beijing could impede the technological progress of competitors who aim to catch up to and establish rare earth supply chains excluding China, ultimately reflecting similar national security considerations as the protesting Biden administration.⁵³

Transatlantic Convergence?

Even as the U.S. proceeded with sanctions unilaterally, U.S. chip equipment companies emphasized from the beginning that unilateral restrictions would come at the cost of American competitiveness. Among the five companies that dominate the global market for chip manufacturing equipment, three are American—Applied Materials Inc., Lam Research Corp., and KLA Corp—while Tokyo Electron is based in Japan and ASML in the Netherlands. Meanwhile, Japan and Germany also host multiple leading producers of chemicals and optical systems used as inputs in the semiconductor manufacturing process.⁵⁴ In late October, U.S. Commerce Secretary Gina Raimondo signaled it

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might take nine months before a multilateral deal could level the playing field, albeit confident that allies would eventually follow.⁵⁵

However, Washington's push for the EU to impose an advanced chip export ban on China met an unenthusiastic crowd.⁵⁶ Though special one-year export rule exemptions had been provided to South Korea, Taiwan, and Japan, the fact remained that export controls were used to force compliance abroad, and by deploying unilateral sanctions so forcefully, Washington had thrown misgivings on its willingness to accommodate allied interests.⁵⁷ Given past successful attempts at forcing European companies into compliance with U.S. extraterritorial laws, EU leaders were wary, with close high-level institutional coordination.⁵⁸ In a November EU Parliament debate on EU-China relations, HR/VP Josep Borrell called the U.S. the EU's "most important ally," albeit stressing positions and "approaches vis-à-vis China would not always be aligned."⁵⁹ This reluctance was again illustrated at the December EU-U.S. TTC, where Washington's insistence on including language on China was rebuffed, notably amid high tensions over U.S. industrial policy.⁶⁰

Echoing HR/VP Borrell in November, Dutch Trade Minister Liesje Schreinemacher stressed the Netherlands would not directly align with U.S. policy to restrict ASML machine sales to China.⁶¹ Though the Dutch Security Services has labeled China a threat to the Netherlands' economic security,⁶² authorities were not convinced that a broad-based U.S.-style ban would be proportionate or appropriate. Instead, the government has prioritized country-neutral investment screening powers and considered legislation introducing enhanced oversight of foreign students attending Dutch universities handling sensitive technologies.⁶³ At the time, ASML was notably expanding operations in China, having removed all American employees from China-related projects. The company opposed further export restrictions on older lithography machines, citing supply chain

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disruptions amid already tense global shortages.⁶⁴ As ASML's main exports to China had limited reliance on U.S. technologies, they fell outside of the reach of U.S. export administration restrictions.⁶⁵ Neither did they classify under the 2019 Wassenaar Arrangement of dual-use goods, which already restricted the sale of ASML's most advanced EUV technology. Still, U.S. officials had ominously suggested the export framework could be expanded to products that contain “any U.S. components or intellectual property.”⁶⁶

Even as the EU has remained internally divided on in what direction to advance the fraught Sino-European relationship,⁶⁷ U.S. overtures have had the overall upper hand over Beijing's diplomatic counteroffensives. Mere hours after news broke about a tentative agreement between the U.S., the Netherlands, and Japan in late January, EU Commissioner for Internal Market Thierry Breton notably expressed full agreement “with the [U.S.] objective of depriving China of the most advanced chips,” albeit stressing measures should be “limited to what is necessary from a security point of view.”

⁶⁸ Commission President Ursula von der Leyen subsequently held a summit with President Joe Biden in March, signaling closer cooperation with the U.S. on a multitude of issues, including China.⁶⁹ Nevertheless, the EU-U.S. TTC statement in May was again watered down⁷⁰—not all member-states have appreciated the Commission's forward-leaning pro-transatlantic stance, which some senior figures

in the EU Council have seen as infringing on its exclusive mandate to set EU foreign policy.⁷¹

Von der Leyen has since January developed a notion of economic “de-risking,” as opposed to economic decoupling from China. Crystallized in the June 20 proposal for an EU Economic Security Strategy, the Commission’s de-risking concept seeks to create greater oversight and control of sensitive technologies and supply chains while simultaneously expanding trade in less critical areas. The country-agnostic strategy proposal stays clear of the sensitive issue of transferring additional powers to the Commission, instead encouraging more EU coordination and the creation of an appropriate initiative by year’s end.⁷² The EU Council has since committed to “de-risk and diversify where necessary and appropriate,” albeit stressing that the EU does not “intend to decouple or to turn inwards.”⁷³ However, with the proposal still at the ideation stage, it is too early to say if momentum will build for a muscular EU-level response—like the 2023 Anti-Coercion Instrument—or instead result in a broader guiding

framework of recommendations akin to the 2020 EU Toolbox for 5G Security.⁷⁴

Just how far the undisclosed U.S.-Netherlands-Japan agreement will ultimately restrict chip trade with China remains unknown, and Beijing has called for a WTO review,⁷⁵ with Chinese chip companies scrambling to stockpile equipment.⁷⁶ Since July, Tokyo has implemented country-neutral export controls on 23 types of leading-edge chip technologies, with Trade Minister Yasutoshi Nishimura insisting the measures would not constitute an outright ban and that sales for non-military certified uses would continue.⁷⁷ Dutch Trade Minister Schreinemacher has similarly clarified the Netherlands’ country-neutral export controls would take effect from September 1 and include advanced DUV machines, aiming to prevent undesirable end uses, like “military deployment or in weapons of mass destruction,” as well as “long-term strategic dependencies.”⁷⁸ Beijing has nevertheless continued the diplomatic courtship, hoping to soften the restrictions. Vice Premier Han Zheng met Prime Minister Rutte and key ASML spokespersons in mid-May,⁷⁹ with Foreign Minister Wopke Hoekstra reciprocating with a visit to Beijing. Premier Li Qiang notably called the Netherlands China’s “priority partner” in the EU, urging joint resistance towards “camp confrontation and a new cold war.”⁸⁰

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Challenges Ahead

The U.S. and European partners appear to have found a workable modus vivendi for now. Even as they do not explicitly single out China, the Netherlands and EU Commission are at least partly on board with stricter export restrictions. However, it remains to be seen if they will satisfy Washington, alienate Beijing, or generate pushback from member-states.⁸¹ Moreover, though both Washington and Brussels have embraced von der Leyen’s nascent “de-risking” mantra—launched in Davos in January and institutionalized at the May Hiroshima G7 Summit⁸²—it remains a flexible and fluid concept. Such flexibility facilitates initial

consensus building, sidestepping the larger, often infected “decoupling” debate, but is ultimately prone to varying interpretations. Beijing is already exploring what gap there might be between vague rhetoric and political action.⁸³

Both Treasury Secretary Janet Yellen and National Security Advisor Sullivan have openly borrowed the de-risking concept and rejected the more severe ringing “decoupling” notion as “unrealistic” and “dangerous.”⁸⁴ However, amid bureaucratic turf wars in the administration, it remains unclear to what extent the tonal shift reflects meaningful policy realignment as opposed to rhetorical rebranding.⁸⁵ Hinting at a lack of an established consensus, Assistant Secretary of State for East Asian and Pacific Affairs Daniel Kritenbrink had no ready answer when asked about the distinction between decoupling and de-risking in a congressional hearing on July 20.⁸⁶ While nominally embracing de-risking has allowed Washington to provisionally paper over contradictions with allies, reassure business leaders, and further deepen technological partnerships essential for supply chain diversification, the de-risking discourse’s inconsistencies will sooner or later require clarification.

Though the White House has actively avoided the word “containment,” maintaining its narrow policies are not aimed at harming China or thwarting its development,⁸⁷ there are undeniable collateral effects with far-reaching technology restrictions. Regardless of the merits underlying the October restrictions, the zero-sum ambition of continuously keeping China behind technologically will entail lowering the living standards of over a billion people.⁸⁸ Moreover, while Commerce Secretary Raimondo has rejected that Washington seeks chip self-sufficiency, she simultaneously outlined a desire for the U.S. to be “the only country in the world where every company capable of producing leading-edge chips will have a significant R&D and high-volume manufacturing presence.”⁸⁹ President Biden was similarly explicit when he pledged the global chip supply chain would “start here and end here – in the United States.”⁹⁰

Dormant protectionist tensions could flare up if partners come to question whether de-risking is only about diversification from China or part of a larger unofficial commitment to U.S. tech primacy. Though the EU’s own Chips Act has finally been adopted in July 2023, leading projects for semiconductor expansion have already run into major delays and cost overruns.⁹¹ Meanwhile, wider European industry remains squeezed by energy inflation, competition from Washington’s Inflation Reduction Act, and yet unresolved tariff disputes from the Trump era.⁹² The year 2024 will be a double-election year for both the White House and the EU Commission, and it is conceivable that the brittle status quo could get shaken by diverging economic priorities.

Author –

Johannes Nordin is a Junior Research Fellow at ISDP’s Asia Program and an Associate Junior Research Fellow at the International Development Research Network (IDRN). He holds a BA in Political Science and Economics and completed his Master of Science in International and European Relations at Linköping University. His main research focuses include EU tech and energy policy and Sino-European relations.

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