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White Paper

GEOIntelligence

This GEOIntelligence White Paper is part of a series designed to equip leaders with methods to enhance strategy development and execution. It integrates military and business analysis models to provide strategic assessment, planning, and risk assessment. This report applies these tools to a real-world challenge, namely the People's Republic of China (PRC), to inform senior executive decision making. There will be future reports on other international challenges in the coming months.

China's global influence has transformed in the past forty years from relative insignificance to now where it possesses a high potential to challenge international order. China's global power aspirations pose a significant national security and global economic risk for the United States and free-market economies on multiple dimensions as outlined in several recent Bancroft Capital GEOIntelligence reports. There is growing international pressure for China to act in a manner consistent with international norms and the rule of law – China's approach to these calls is to deny everything, admit nothing, and launch counteraccusations.

Key Points:

- China's strategy is to continue to enhance its already powerful economy, build a world-class military, and to regain territories and sea-space that its leaders believe it rightly owns.
- China's military and economic strategies are aligned; its aggression toward Taiwan and in the South China Sea near-abroad are problematic to say the least. And, combined with growing global status across all elements of national power, China is the pacing threat for the U.S. and the West.
- Within the economic lever of national power, China intends to reorder world influence through its strengths in next generation technologies such as rare minerals, proximity to microchip production, and low-cost labor. In this vein, the U.S. and its allies need to be risk informed and intentional about their strategies for dealing with China and its government-owned companies.
- China's global economic aspirations also include long-term control of key supply chains and resources, including those necessary for the development of next generation energy and Artificial Intelligence (AI) infrastructure.
- China's aggression in its near-abroad to Taiwan and many parts of the South China Sea serves as a forewarning to the international community. An example is Hong Kong after China's assumption of control in 1997 with gradual, but steady changes that increase China's control of freedoms and rule of law, with impacts to free markets.
- That said, U.S. and free-market governments, along with private sector organizations, already have significant investments and dependencies in China, which limits their flexibility in the near to mid-term. Furthermore, China is similarly dependent on the U.S. and its allies for sales of its goods, financial resources, and internet protocols.
- Companies must dynamically map their supply chains, product elements, financial investors and third parties, as well as information technology interfaces to assess their overall direct situational risk to China and the Asia Pacific Region.

China's Grand Strategy:

China's global influence has transformed in the past 40 years from relative insignificance to significant potential to challenge international order. Interacting with China as a global power merits a sense of its strategy and the potential risks of such interaction.

Grand strategy is the use of multiple instruments of national statecraft to achieve strategic objectives often related to, but not exclusively tied to, security. A Brookings Institute author highlights how China's grand strategy developed over the past 30 years. From the 1980s to 2008, China focused on blunting U.S. power to create freedom of maneuver in the Pacific. Then, from 2008 to 2016, China shifted focus to building foundations for China's order regionally within Asia. Since 2017, China has focused on manifesting the Chinese Communist Party's (CCP) phrase "Great Changes Unseen in a Century" exhibited by China expanding its influence globally by seizing promising opportunities, particularly through relationships and ad hoc coalitions, its economy, technology, and military power projection. Overall, China is on a trajectory to displace U.S. global order by 2049, the centennial of the CCP.

A RAND study in 2020 offers a similar analysis asserting China's goals are to ensure it is "well governed, socially stable, economically prosperous, technologically advanced, and militarily powerful by 2050." RAND authors predict China will emerge globally in one of four possible ways – triumphant (least likely), imploding (not likely), ascendant, or stagnant (both being plausible). In RAND's view regarding the United States, "China seeks to manage the relationship, gain competitive advantage, and resolve threats emanating from that competition without derailing other strategic objectives (particularly those in the economic realm)."

In short, China's global power aspirations pose a significant national security and global economic risk for the United States and free market economies on multiple dimensions as outlined in several recent Geo Intel papers. (See Bancroft Capital paper on Great Power Competition Bancroft's GEOIntelligence White Paper on Great Power Competition.) It is reasonable to assert that for the foreseeable future the PRC will be the long-term threat center of gravity to a global rules-based, free-market system and a risky partner for long-term commercial investments.

Economic Considerations with China:

China's economic threat to the U.S. and free-market nations is intensified by its military aggression to control the South China Sea, threatening Taiwan (the largest global microchip production share) and intimidating the Republic of Korea by supporting North Korea. China has also been aggressive toward the Philippines, a favorable offshoring destination for free-market nations.

The global sanctions of Russia, North Korea, and Iran have driven trade volumes and stronger relationships with China, while increasing the imbalance of trade leverage with China. While China depends on the U.S. and free market nations for its own economic security, the increased volume of activity with free market adversaries has partially reduced the near-term impact on its economy.

Furthermore, China's strategic position as a key supplier to global markets over the past decades continues to enable the provision of low-cost imports of finished goods, as well as critical production of components resulting in significant influence with many U.S. companies, especially in the technology and healthcare sectors. China's growing influence spans many other dimensions including cyber and social media, monitoring by embedded chips in machinery, and direct foreign investment in the U.S., including financial and real estate assets. China also threatens IP and property rights by disregarding associated U.S. laws and directly engaging in espionage.

China has global power aspirations for long-term control of key resources for the development of next generation energy and Artificial Intelligence (AI) infrastructures. Many believe advances in next generation technology centered on AI will be the catalyst for economic growth in future decades. The value chain for next generation technology includes energy, rare minerals, microchips, software, and data. Additionally, the control of this value chain will intuitively increase its power. For example, a large concentration of the rare minerals necessary for both sustainable energy and AI are in the Asia Pacific Region and Africa with processing monopolized by the PRC. (See Bancroft White Paper - Bancroft GEOIntelligence White Paper on Resource Security Part 1.) Furthermore, global production of microchips is concentrated in Taiwan, which is under constant coercion and intimidation pressure levied by the PRC. China's actions appear to demonstrate intent to control the South China Sea and the next generation technology value chain to reorder global influence.

Although China's aggression in the Pacific is focused on conflicts with the U.S. and PRC's neighbors in the South China Sea, Hong Kong should be a watch item for anyone doing business with China and serve as a forewarning to the international community. China's assumption of control of Hong Kong in 1997 has provided a mixed example for free market societies to balance given that China likely desires to maintain a global economic power role and appear non-adversarial.

PRC and Hong Kong leaders contend their enactment of the "Article 32" law to fight government subversion has not had an impact on personal freedoms and economic opportunities. However, the reality has been quite the opposite. Although Hong Kong is still an important global investment hub, the result of the changing political dynamics has cooled Hong Kong's economy and influence. Consider the following:

- The impact of China's crackdown in Hong Kong may be slow, but it appears to be a fundamental shift due to the lack of free market trust in the PRC's control.
- The Hong Kong exchange (Hang Seng Index) has dropped 40% since 2019.
- Free market banks, insurance companies, and wealth managers have remained present in Hong Kong as it is still a global financial center even with political tension. But the risk to global markets from the PRC is high. As the financial market evolution focuses on fintech, digital transactions, and cybersecurity, it becomes evident that the PRC seeks access to global financial transaction data through Hong Kong's integration in international markets.
- There has been an exodus of judges. Recently, another foreign supreme court justice, Jonathan Sumption, resigned stating, "Hong Kong, once a vibrant and politically diverse community, is slowly becoming a totalitarian state. The rule of law is profoundly compromised in any area about which the government feels strongly."
- The crack down on freedom of speech has brought most public dissent to a complete halt, while breaking trust with the international community.
- Long term international investments by free market private sector organizations are being redirected to places like Singapore and Japan, which have better track records on respecting the rule of law.

The Chinese Foreign Investment Law (FIL) of 2020 was an attempt by the PRC to demonstrate its commitment to foreign investors putting their money into China. However, additional national security laws enacted by the PRC enable the government to retain the legal and physical access to any company in which a Chinese citizen operates – anywhere in the world. The law compels any Chinese entity or citizen to turn over information to the PRC at the will of the government. The PRC national security laws provide real front door and back door access for the PRC that would violate national sovereignty and legal privacy rights that are normal expectations of free market and democratic societies.

The PRC Data Security Law of 2020 signals that the PRC legal controls are not designed solely to protect domestic activities in China, but rather to force foreign markets to remain open to Chinese data services providers.

The strategic conundrum for foreign investment in China lies in balancing the allure and the apprehension of accessing the Chinese domestic markets contrasted with deciding where to move production to tap into opportunities in currently underperforming markets (e.g. India). Case in point, Apple is currently overinvested in China and moving some of its production to India and Foxconn moved production from China to Vietnam. Despite all these factors, companies already invested in China, many with long-standing relationships, have accepted the geopolitical risk of conducting business with and in the PRC. Their rationale appears to be securing access to Chinese labor and consumer markets. The growing geopolitical uncertainty due to China's government-sponsored aggression and coercion toward foreign businesses and nation states has pushed companies to consider how to maintain access to China's markets and sustain the value of their investments while strategically derisking their interests. Derisking methods range from establishing physical, virtual, and legal firewalls to protecting current interests and shifting investments outside of China that are free from intrusive PRC policies.

Companies are also driven to map their supply chains, product elements, financial investors, and third parties, as well as information technology interfaces to assess their overall direct situational risk to China and the Asia Pacific Region. This situational analysis can then provide a basis for developing the strategic options and feasibility of strategic pivots.

Assessing the Environment:

Assessing organization, market, and national security risk for individual businesses can be accomplished through the use of a Geo Intel Dynamic Risk Assessment model (see: Bancroft GEOIntelligence White Paper on the Intersection of National Security and Corporate Strategies). It starts with leaders framing the environment and conducting an assessment specific to their situation and developing strategic options for business decisions.

There are four tools that intersect in the model for senior leaders to use when considering how to navigate China's positioning (note that these tools will be applied to China in part 2 of this White Paper series):

- Political, military, economic, social, information, infrastructure, physical space, and time (PMESII-PT).
- Porters 5 Forces: supply power, buyer power, competitive rivalry, new entrants, and substitutes.
- Organizational Risk Frameworks that use criteria specific to a business and industry.
- SWOT, or Strengths, Weaknesses, Opportunities, and Threats analysis.

Implications and Forecast:

- China's strategy is to reorder world influence through its current strengths in next generation technologies such as rare minerals, proximity to microchip production, and low-cost labor.

- China's military and economic strategies are aligned; its aggression toward Taiwan and its developing relationship with North Korea provide insight to its focus on technology hubs.

- China's laws regarding data access highlights the importance of data in training AI models.

- U.S. and its free-market governments and private sector organizations already have large investments and dependency in China, which limits their flexibility in the near to mid-term.

- China is dependent on the U.S. and its allies for sales of its goods, financial resources, and IP.

- The U.S. and its allies need to be aware and intentional about their strategies for dealing with China and its companies.

- Derisking options from China can be evaluated through the Dynamic Geo-Intelligence (e.g. PMESII-PT, Porter, Organizational Risk Frameworks, and/or SWOT) models to enable risk informed decisions about supply chains, near-term and long-lead investments in raw materials, property, plant, equipment, and access to labor to stay competitive in current markets and shape the landscape for competing effectively in emerging markets.