

## COVID-19 continues to fracture the geopolitical landscape

By Angelo Katsoras

### Summary

COVID-19 is creating several geopolitical tension points that could far outlast the pandemic, including:

- intensification of what is likely to be a decades-long competition between China and the United States for economic and geopolitical supremacy;
- the perception among a growing number of countries that China is waging an overly aggressive campaign to deflect blame for the pandemic; and
- the escalating battle between the two superpowers for control of the global standards in cutting-edge technologies.

### U.S. steps up targeting of China

Over the past two months or so, the United States has taken many significant measures against China with strong bipartisan support, including several bills currently in the congressional pipeline likely to reach the two-third majority required to overcome a potential presidential veto. Here are several examples:

- The ban on U.S. chipmakers supplying Huawei has been extended to include preventing foreign semiconductor manufacturers from sending products made with U.S. technology to Huawei without approval. While Huawei could manage without U.S. semiconductors, factories where their substitutes are produced still rely on American components.<sup>1</sup> The executive order, which was adopted May 15, has a 120-day grace period before going into effect. Not surprisingly, China has promised to retaliate if the rule is fully implemented. In an attempt cushion the blow from ever-tightening U.S. sanctions, Huawei has reportedly stockpiled large quantities of American chips.
- The U.S. Commerce Department announced on that it was adding 33 Chinese companies and other institutions to an export blacklist for human rights violations and ties to China's military. Just over a year ago, China announced it was considering drawing up its own "unreliable entity list" but has yet to publicly target any companies.
- The Federal Communications Commission permitted Google and Facebook to activate the section of their recently built 8,000-mile undersea Pacific Light Cable Network from the United States to Taiwan but not to Hong Kong owing to national security concerns.
- The U.S. Federal Communications Commission warned China Telecom, China Unicom Americas, Pacific Networks and ComNet that, if they failed to provide evidence of no links to the Chinese government, they would lose the right to operate in the United States.
- In response to China's refusal to allow the SEC to examine the audit papers of its companies, the Senate unanimously approved legislation that would delist companies from the Nasdaq or NYSE that refused to have their audits inspected for three consecutive years. While a date for a vote in the House of Representatives has yet to be scheduled, Chinese firms Alibaba and jd.com are already listing new shares in Hong Kong.
- The Uyghur Human Rights Policy Act of 2020, which was overwhelmingly approved by both the Senate and House of Representatives in May, provides for action to be taken against Chinese government officials seen as being responsible for forced-labour camps. This veto proof majority virtually guarantees that it will be signed into law.
- The U.S. Commerce Department and other agencies are looking for ways to encourage companies to move their manufacturing out of China. Tax incentives and subsidies are among measures being considered. White House economic adviser Larry Kudlow recently stated: "If we had 100 percent immediate expensing, we would literally pay the moving costs of American companies from China back to the U.S."
- The Trump administration is reportedly planning to cancel the visas of thousands of Chinese graduate students and researchers studying in the U.S. who have ties to universities affiliated with the Chinese military.<sup>2</sup>

<sup>1</sup> "The silicon war between the US and China is turning hot," The Telegraph, May 17, 2020.

<sup>2</sup> "U.S. to Expel Chinese Graduate Students With Ties to China's Military Schools," New York Times, May 28, 2020

Since convening in January 2019, the current Congress has introduced a total of 320 China-related resolutions.<sup>3</sup> The combined impact of all these actions is placing companies with operations in both the United States and China between a rock and a hard place: Comply with Chinese law and be in violation of U.S. law, or vice versa.

## Hong Kong status as a global financial center under threat

Under the Hong Kong Human Rights and Democracy Act passed in November 2019 with overwhelming bipartisan support, the United States is required to make an annual determination whether the “one country, two systems” formula that guarantees Hong Kong’s independent legal system is intact. The answer given by Trump on May 29 was a resounding no. This decision plus the strong bipartisan support for a harder line following the arrest of pro-democracy activists and Beijing’s new Hong Kong security law makes it likely strong measures will be taken. These could include:

- the ending of visa-free travel between the United States and China
- Making Hong Kong subject to the same tariffs and restrictions imposed on China, particularly when it comes to the import of advanced US technologies.
- threatening Hong Kong’s status as an independent member of the World Trade Organization,

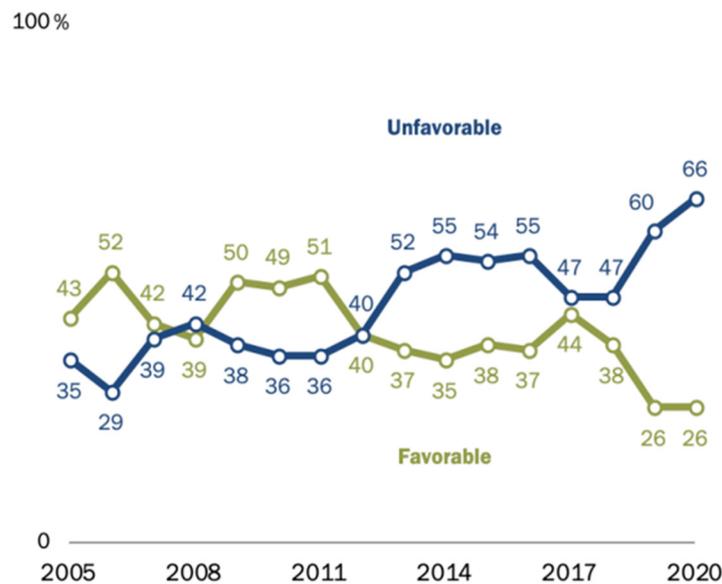
The U.S. announcement that Hong Kong and its legal system are no longer sufficiently autonomous from China to merit its special status means its standing as a global financial center will likely diminish. This will be coupled by Chinese efforts to shift crucial financial market activities and trade to the mainland. Further, as Hong Kong is increasingly absorbed into China, the viability of maintaining its own currency, which is pegged to the US dollar, could eventually be called question.

## China will be major issue in upcoming U.S. election

The driving force behind this trend is a growing anti-China sentiment. According to a Pew survey conducted in March, roughly two thirds of Americans now say that they have an unfavourable view of China, up nearly 20% since the start of the Trump presidency.

### Negative views of China continue to grow in U.S.

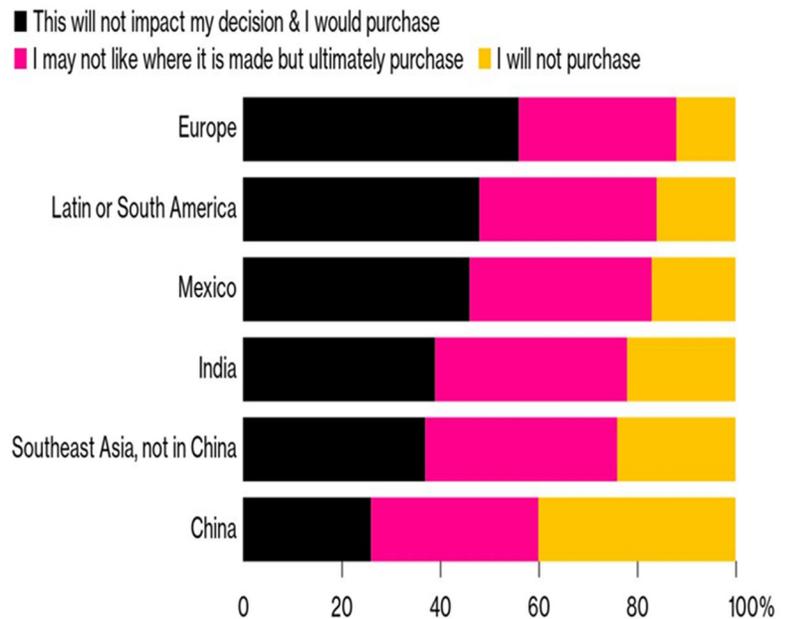
% who say they have a \_\_\_ opinion of China



Note: Don't know responses not shown.  
Source: Survey of U.S. adults conducted March 3-29, 2020. Q5b.  
"U.S. Views of China Increasingly Negative Amid Coronavirus Outbreak"  
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### Cold Shoulder

New poll of Americans shows 40% won't buy Made-in-China products



Source: FTI Consulting

**Bloomberg**

<sup>3</sup> "Trade Deal With China Faces Threat. What Investors Should Be Worried About," Barron's, May 7, 2020.

Biden and Trump are each trying to accuse the other of being too soft on China. On the one hand, the Trump campaign has researched years of Biden statements on China and has highlighted his son's business dealings in China. On the other, Biden's campaign has reproached Trump for saying in January and February that he trusted the Chinese government was doing all it could to halt the outbreak, and for not doing enough to convince fellow allies to adopt a common position against Beijing's trade policies.

Trump will also argue that the present tight supply of medicine and healthcare equipment is another example of how past U.S. governments have allowed production in key sectors to relocate abroad, including to countries that have emerged as major geopolitical rivals.

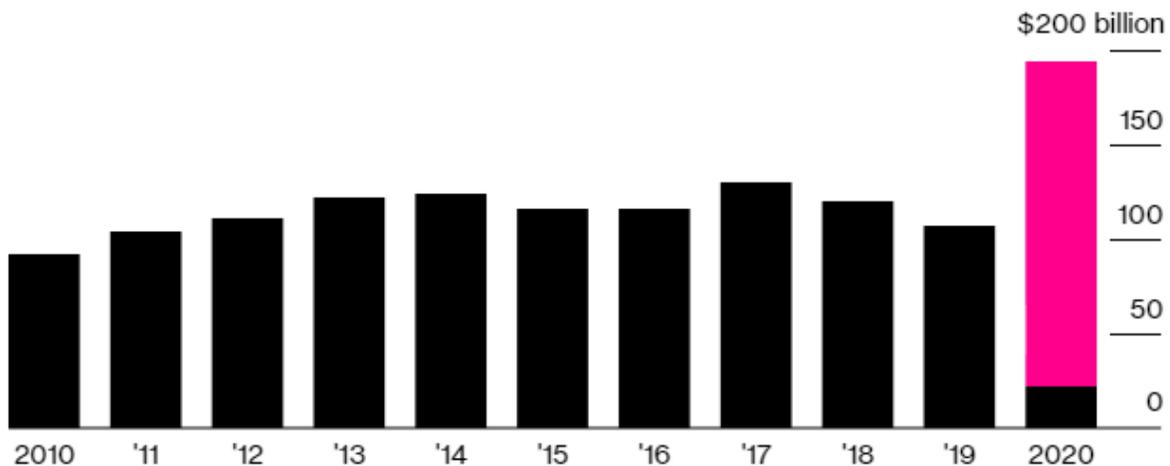
### Trade deal less viable with each passing day

Even before the COVID-19 outbreak, China's pledge to purchase \$200 billion more in U.S. manufacturing, agriculture, energy and services exports over the next two years than it did in 2017 would have proved very hard to honour. This is because the deal entails an increase in exports to a single country without precedent in the history of U.S. trade outside of World War II.<sup>4</sup> Now, with the economic impact of COVID-19 unfolding and tensions between the two countries worsening, attaining these targets seems virtually impossible. Indeed, instead of China making headway towards the goal of increasing imports by \$76.7 for this year, imports from the United States declined 5.9% in the first four months of 2020 from a year ago.<sup>5</sup> The only open question is how much longer both sides will in the face of mounting evidence to the contrary continue to maintain that the deal is still on track.

#### A Long Way to Go

U.S. exports to China need to expand quickly to reach the 2020 target

- U.S. goods export to China (2020 data is from Jan.-Mar.)
- Remainder of target for first year of trade deal



Source: U.S. Census Bureau, U.S. Trade Representative

Source: "U.S., China Trade Chiefs to Speak as Trump Threatens Deal," Bloomberg, May 7, 2020

### China's relations with several other countries deteriorating

China is facing mounting international criticism over its handling of the COVID-19 pandemic and its aggressive diplomatic campaign to deflect blame. Below are some of the growing number of countries that have been angered by China's recent actions:

**France:** In February, Finance Minister Bruno Le Maire stated: "Do we want to still depend at the level of 90 percent or 95 percent on the supply chain of China for the automobile industry, for the drug industry, for the aeronautical industry, or do we draw the consequences of that situation to build new factories, new productions, and to be more independent and sovereign?"<sup>6</sup> Soon after, President Emmanuel Macron, referring to the lack of free flow of information in China, said: "Let's not be so naive as to say it's been much better at handling this. There are clearly things that have happened that we don't know about."<sup>7</sup> Finally, the French foreign office recently

<sup>4</sup> "U.S., China Sign Deal Easing Trade Tensions," Wall Street Journal, January 15, 2020

<sup>5</sup> "U.S., China Trade Chiefs to Speak as Trump Threatens Deal," Bloomberg, May 7, 2020.

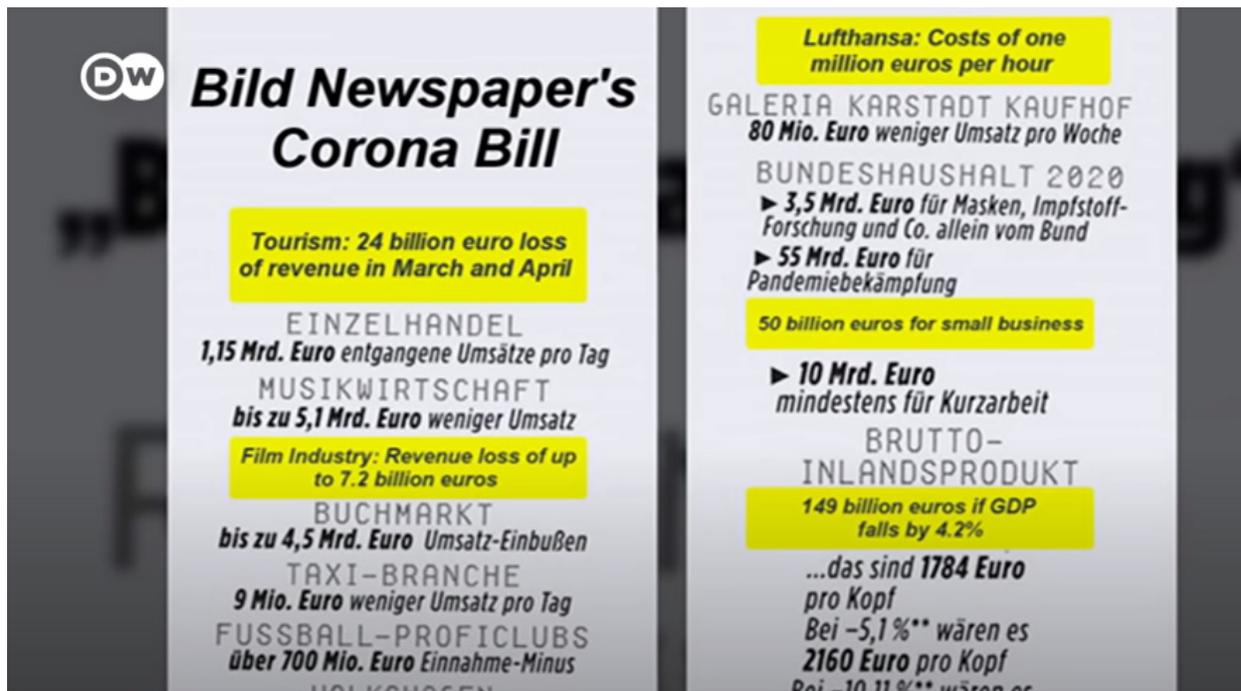
<sup>6</sup> "At G20 meeting, globalization comes under fire amid coronavirus 'stress test'," Japan Times, February 23, 2020.

<sup>7</sup> "FT Interview: Emmanuel Macron says it is time to think the unthinkable," Financial Times, April 16, 2020.

summoned the Chinese ambassador to express its deep disapproval of a posting on China's embassy website stating that France had essentially left its senior citizens to die.<sup>8</sup>

**UK:** The PM has reportedly instructed civil servants to work on ending Britain's reliance on China for crucial imports. This includes phasing out Huawei's involvement in building its telecommunications networks by 2023. If confirmed, this would mark a major reversal from January when the UK decided to allow Huawei into non-sensitive parts of its 5G network.

**Germany:** Certain German media outlets are tilting against China. In an article titled "What China Owes Us", the editor-in-chief of Bild, the country's largest newspaper, accused China of lying about the COVID-19 outbreak: The editorial goes on to state that China owes Germany €149 billion for damages caused by the pandemic. The Chinese embassy in Germany angrily responded by accusing Bild of fueling prejudice and hostility against China.<sup>9</sup> A poll taken in May has found the Germans view of the Chinese government has taken a turn for the worse: 77% of German respondents said China was at least partly to blame for the virus, while 74% felt China had dishonestly reported its infection rates.<sup>10</sup>



Source: "The Day: German tabloid Bild demands China pay billions in coronavirus damages," Deutsche Welle, April 17, 2020.

**Japan:** The country has pledged over \$2 billion to help companies move their production out of China in an effort to gradually reduce its reliance on the Asian giant. In a sign of further tensions, Deputy Prime Minister Taro Aso recently noted that some people had started referring to the World Health Organization as the "Chinese Health Organization" because of its alleged deference to China.<sup>11</sup>

**Australia:** China halted imports of some Australian beef and barley after the Australian Prime Minister called for an investigation into the World Health Organization and the origins of the COVID-19. "Maybe the ordinary people will say, 'Why should we drink Australian wine, eat Australian beef?'" remarked China's Ambassador to Australia.<sup>12</sup>

**Canada:** In a departure from Canada's habitual cautious tone, Canada's ambassador to Beijing recently said that China's aggressive diplomacy had alienated many countries. A ruling by a B.C. Supreme Court judge stating that extradition proceedings against Meng Wanzhou could proceed will likely further exacerbate tensions between Canada and China, though the Huawei executive still has several avenues left for appeal. Perhaps even more importantly, the following polling data indicates that opinions of China have soured in recent months.

<sup>8</sup> "How China Is Losing Europe," Bloomberg, May 7, 2020.

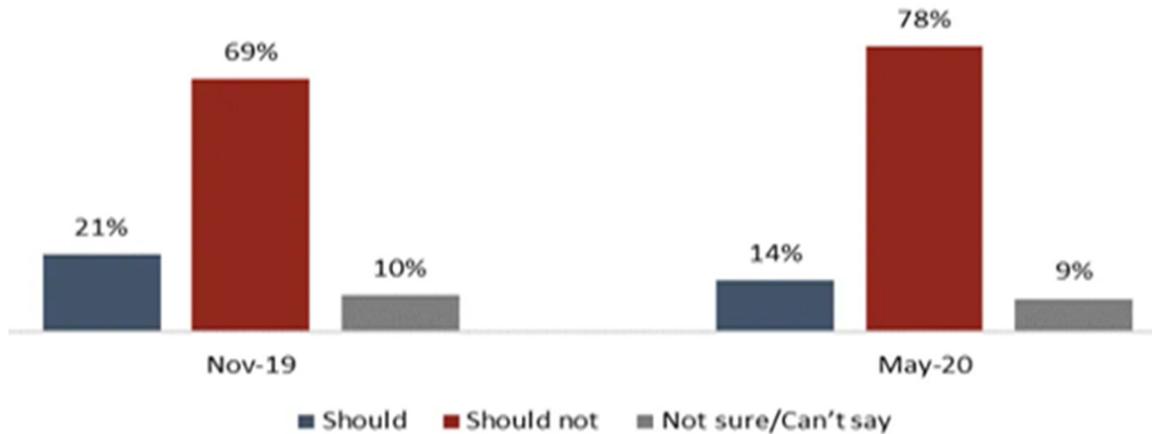
<sup>9</sup> "Covid-19 trouble brewing behind EU-China ties," Asia Times, April 24, 2020

<sup>10</sup> "Germans pin coronavirus blame on China: poll," Politico, May 11, 2020 & Redfield & Wilton Strategies

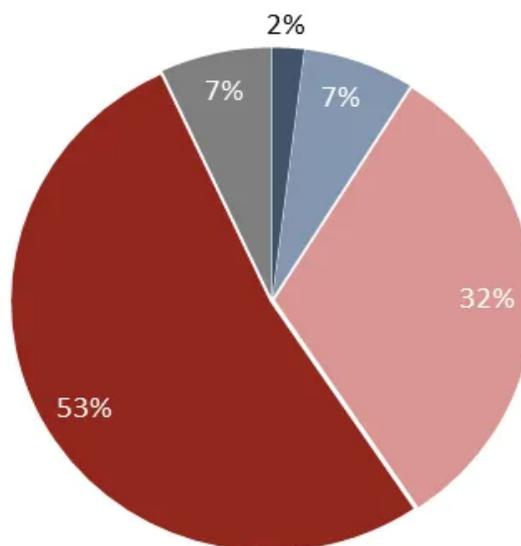
<sup>11</sup> "The Chinese Health Organization?" Japan Times, April 29, 2020.

<sup>12</sup> "Global Backlash Builds Against China Over Coronavirus," NY Times, May 3, 2020.

**Do you think the federal government should or should not allow Chinese telecom company Huawei to be involved in building Canada's 5G mobile networks?**



**Agree vs Disagree: "The Chinese government has been transparent and honest about the COVID-19 situation in that country"**  
(All respondents, n=1,518)



■ Strongly Agree   ■ Agree   ■ Disagree   ■ Strongly Disagree   ■ Don't know/Can't say

Source: "Canadian opinions of China reach new low," Angus Reid Institute, May 13, 2020.

## Competition growing for control of global standards

The mutual desire of the United States and China to rely less on one another's technology and equipment is speeding up the development of different technical standards in various sectors. In an effort to leverage their geopolitical influence, each side is pushing for its standards to become the global norm.

Once a global standard is adopted, others must rely on the country or company that set the standard for consulting, spare parts, data management, and updates. Further, similar to how the United States can restrict a country's access to the dollar-denominated global financial system, the country whose technology controls, say, the telecommunications networks in a certain region could more easily engage in cyber espionage or restrict network access to geopolitical rivals.

Below are several examples of how this competition for the control of global standards is unfolding:

- China is near completion of its very own GPS system called BeiDou-3 to compete with America's GPS network, the satellite navigation technology that we use in smartphones.
- China is pushing to make its facial recognition and video monitoring technology the standard at the UN International Telecommunication Union (ITU). Historically, technology standards ratified by the ITU have been adopted by several regions.
- China recently failed in its attempt to have its diplomat Wang Binying appointed at the head of the World Intellectual Property Organization. Instead, Daren Tang, head of Singapore's intellectual property office, was made Director-General with U.S. support.
- In what can be viewed as a successor to Made in China 2025, Beijing will soon release **China Standards 2035**, a 15-year blueprint laying out its plan to set the global standards for the next generation of technologies.
- The United States is reportedly pushing the idea of an "Economic Prosperity Network" involving such countries as Japan, India, South Korea, Vietnam and Australia. This alliance would include a "set of standards on everything from digital business, energy and infrastructure to research, trade, education and commerce."<sup>13</sup>

## Conclusion

China and the United States are increasingly competing in the spheres of economic policy, standards and technology. As a result, market access in sectors deemed strategic by both sides will often depend on whether a company's business plans, products/services and supply chains are compatible with the standards and geopolitical objectives of one or the other country. Based on these criteria, the company with the best products or services will not always be the one to come out ahead.

In an attempt to maintain some level of access to both markets, companies in strategic sectors will increasingly set up two separate supply chains, one for the United States and one for China. This will mean higher logistics costs but still no guarantee of maintaining market access. A perfect case in point is the dilemma faced by The Taiwan Semiconductor Manufacturing Company (TSMC), the world's top producer of leading-edge performance microchips. In addition to being a key supplier to both Apple and Huawei, it makes microchips for the U.S. military. TSMC recently announced plans to build a \$12-billion chip factory in Arizona. This was done both to ease U.S. fears of Chinese espionage and to help lobby the Trump administration to be exempted from looming U.S. restrictions on companies shipping chips produced with American technology to Huawei. Complicating matters further for TSMC, Huawei is reportedly pushing for it to both relocate more production to China, and set up production lines free of U.S. technology and components.<sup>14</sup>

Protectionism will increasingly also force corporations to base production closer to points of consumption. This means that instead of manufacturing goods mostly for export, many factories in China will gradually focus more on producing goods for domestic consumption and nearby regional markets, while products destined for North America will increasingly be produced regionally.

Finally, cross-border mergers & acquisitions are also becoming more difficult to execute as a growing number of countries, including Australia, Germany, France, India and Canada, are taking measures to limit takeovers from certain foreign investors looking to buy strategic assets on the cheap in the midst of the pandemic.

<sup>13</sup> "Trump administration pushing to rip global supply chains from China: officials," Reuters, May 4, 2020.

<sup>14</sup> "Chip titan TSMC caught in the crossfire between US and China," Nikkei Asian Review, May 15, 2020



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