



 KCS Country Risk & Threat Advisory

KCS Group Europe  
Risk & Threat Advisory Paper

Political Risk Advisory Briefing: China  
June 2021

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|  | <b>Country:</b>    | China              |
|   | <b>Population:</b> | 1,444,460,017      |
|   | <b>Source:</b>     | CIA World Factbook |

**China has a risk rating of 4.**

- 6 Very High** The assorted threats described in the report are almost certain to have a derogatory effect.
- 5 High** The threats are extremely likely to negatively affect the business.
- 4 Very Possible** There is a strong likelihood of problems arising in this country.
- 3 Possible** There is a fair chance of problems arising in this country.
- 2 Low** There is a low likelihood of any threats impacting business.
- 1 Very Low** There are virtually no impediments to successful business in this country.



## Overview

One might think that it is only a matter of time before China becomes the most powerful nation in the world, unopposed by the likes of the US or its Western allies either economically or militarily. Yet the last 18 months to 2 years have seen China face difficulties on almost all fronts and the Chinese Communist Party's (CCP) responses have certainly contributed to them. Moreover, President Xi's confidence appears to hinge exclusively on the weakness observed in the current US administration and his partnership with Putin, and it is fair to say that all is not quite as it seems.

## A real partnership with China?

Although rarely spoken of these days as it does not support the political narrative either for the US and its allies or that of the two Asian power players, Russia historically does not trust China. President Yeltsin was in fact quite reticent to engage China in a strategic partnership back in the late 1990s in which it should be understood China was very much the suitor. Regardless of the way the West has treated Russia since the end of the Soviet Union, the Kremlin had always hoped that the relationship would eventually thaw.

While there is little choice for Putin but to openly support China in some of its dealings with the West at this time (including talks of strategic military partnership), he must play a balancing act in order to ensure Russia does not become a vassal state of China by bolstering his own country's relationships with others in the region.

Although the failure of the Chinese military to project Beijing's strength against India in two separate clashes along the disputed border in the Galwan River Valley in May 2020 and North Sikkim in January this year was a bad enough PR disaster for Xi, worse still, was the fact Russia chose to stop supplying China with military hardware yet continued to do so for India. This signalled that Putin will not just follow China's direction blindly and that he sees the potential threat to Russia from China in the medium term, believing India to be the support needed to reign in an over-confident Xi at some point.

Russia lacks the financial firepower of China for its international investments, yet it still punches far above its weight, offering such things as access to abundant energy resources and advanced military hardware. As a result, it has managed to gain footholds in countries for a far lower price than China's 'Debt Trap' model. Having seen India's improving relationship with the US under the Trump administration turn sour under the current Biden one, Russia has

been able to 'kill two birds with one stone' by engaging more fully with its long-term ally (India) at the expense of the US and China while at the same time improving its standing in Pakistan, which the Kremlin will need on side if it is to make head way with the Afghan peace talks.

Russia's foreign minister Sergei Lavrov's visit to India and then to Pakistan provides evidence that the Kremlin is not at all comfortable with China's foreign policies in the region. While China has been threatening aggression around the region and more specifically the world, Russia has been on a charm offensive. Lavrov's meeting in Pakistan (a China ally) bearing gifts of 50,000 Sputnik V vaccines would appear successful in terms of lowering the overall temperature – even if seen by India as somewhat vexing.

As far as the offer of military assistance to Pakistan, however, this can be viewed as part of a peace balancing act. Putin does not have any intention of making Pakistan more powerful as a military as this could turn and bite him if the relationship with China soured. Also, Pakistan is in no position to buy military hardware without approval from Beijing, and it is already in deep financial debt to China.

For Pakistan, the real value of the talks came not from the offer of military assistance but from the possibility of licencing agreements for Pakistan to manufacture the Russian vaccine in-country and the potential building of a north-south gas pipeline. The country's economy was already suffering a very hard and deepening crisis before the arrival of the pandemic, so these projects offer the chance of generating much needed revenue streams. The real value for Russia will come from improving relations with an ally of China and giving that country alternatives in future negotiations while creating the potential to strengthen peace in Afghanistan with Pakistan's help.

Putin has already found that dealing with the CCP as a strategic partner can be difficult. This could be seen when he found out the CCP had a rather laissez-faire attitude toward Russia's copyright law over the Sukhoi 27 jet fighters supplied to it and had copied without permission (albeit poorly). It should also be noted that among many other contentious issues, the CCP – clearly offended by Russia's response to the clashes with India – allowed one of its journalists from China Global Television Network to Tweet on the 160<sup>th</sup> anniversary of Vladivostok that:

*“The history of Vladivostok (literally 'Ruler of the East') is from 1860 when Russia built a military harbor. But the city was Haishenwai as Chinese land, before Russia annexed it via unequal Treaty of Beijing.”*

Given that China has border disputes with 18 other countries based on the tenuous historical land/sea ownership status dating back to the 13<sup>th</sup> and 14<sup>th</sup> centuries, it is clear it will eventually escalate this claim over Vladivostok should Russia step over an imaginary red line yet to be determined. Putin will be concerned about this and wondering just how far the CCP might take this claim if it felt it could do so without interference. There are in fact several areas of land along the borders between China and Russia that are not claimed directly by either country. While there is no dispute over them currently, they could well be potential matters of conflict in the future.

China has been trying hard to gain access to Russia's far eastern territory, offering huge sums of money as part of a Chinese investment programme as it is resource rich. This could be seen potentially as a prelude to Beijing's attempt to take control of parts of Russia thereby weakening it from within. However, it is very unlikely Putin would make such a mistake as he has seen this game plan play out all too often, especially in Africa. So far, he has resisted all offers by China to pour investment money into the region.

### **China's soft power is losing effectiveness...**

While Putin has blocked some Chinese investment money into his country, he is also (in conjunction with India) competing directly against China in terms of influence in Africa and has been making good progress. Where China tricks African nations into debt traps for infrastructure loans - as Zambia has just found out to its cost having had to give up its mines to pay off some debt to China - Russia tends to offer more realistic financial loan programmes, military protection, military training as well as joint rail projects with India for far lower prices. As a consequence, Russia is seen in a far better light than China on the African continent and has been able to take ground previously enjoyed by China, if only as a way to keep the US out of the picture.

It would appear that an anti-China sentiment is growing on the African continent, as many governments have begun to realise that the promise of the Belt and Road initiative will have been bought and paid for with African money, African resources and, eventually, the countries themselves. Working collectively, many African nations have managed to force China into

offering debt suspension periods. Signing off on the debt suspension for more than 11 African countries has left China vulnerable. It is estimated that Beijing is currently owed somewhere in the region of US\$150 billion and has been forced to reduce the amount of further investment into the region by more than US\$2 billion over the last year alone. It is also believed to be considering further reductions.

The political row developing apace between Australia and China, has revealed another vulnerability for Beijing. China began to invoke trade bans of around US\$4 billion against Australia due to Canberra's criticisms of Beijing's handling of the pandemic but also as a result of its demands to have scientists investigate what it believes is ground zero for the virus. While the ban could be viewed as punishment for Australia, it is also a case of 'cutting your nose off to spite your face' where China is concerned. China desperately needs to import massive quantities of iron ore if it is to maintain its position as a global manufacturing base, and the same again for coal if it to maintain power supplies to its people. No doubt Beijing believes that the necessary supplies will come from Russia, but if it does, the deal will by default provide additional leverage for the Kremlin in future deals.

### **The United States**

While it is true that Beijing's imposition of the National Security Law in Hong Kong last June remains unchallenged in any meaningful political sense (seen as a political win for Xi), it did draw international attention toward Taiwan and China's stated intentions to control it at some point in the not-so-distant future – forcefully if necessary. This action alone has seen a massive dampening of support for Beijing in Europe as well as in parts of Asia, therefore, further weakening its soft power.

Former US President Donald Trump did impose sanctions against China in relation to Hong Kong during his time in office, such as blocking the listing of Chinese registered companies from the US stock exchanges as well as officially recognising Taiwan as an independent sovereign nation. He also sent high level ambassadors for talks with Taiwan's officialdom and ramped up supply of military hardware there. Despite President Joe Biden's China friendly actions such as the back tracking of sanctions against Chinese businesses, going as far as removing tech giant Xiaomi from the US blacklist, it is clear the extinguishing of Trump's hard-line rules against China is not happening fast enough for the CCP.

Frustrations were made worse at the last US–China talks in Alaska. Biden had invited Xi Jinping’s delegation in an attempt to repair relations between the two countries in February. Yet Biden has been struggling to appear to fight for America’s interests while at the same time appeasing the CCP. In what can only be described as a monumental error in judgement while attempting to shrug off the image of a ‘China lackey’ that had been created for him by Trump in the 2020 election campaign, Biden placed further sanctions on China just after that invite. The Chinese delegation realised the talks were intended to be an ambush, and they were ready and prepared for it. What followed was a long and brutal attack against the US’ own internal ‘race’ issues, economy and foreign policy.

Indeed, not long after the talks, Xi Jinping adopted a new official job title for himself: ‘Helmsman’. This should be considered a concerning development for the West as it comes to terms with the fact ‘Cold War 2.0’ is now a reality regardless of what political spin is put on it, but perhaps far more so for the Chinese public as the last Chinese leader to use this title was Mao Zedong. Reading between the lines on this issue, however, suggests the recent show of strength from Xi is in fact a sign that indicates internal fractures are growing between the political fractions that make up the CCP.

Moreover, as Xi Jinping applies ever more draconian rules on the Chinese people there would appear to be disquiet developing at ground level. Though it is not thought that the people are likely to ‘rise up’, it is possible the opposition to Xi’s side might attempt to use this disquiet to support their argument, especially as more and more people find themselves without a home following yet another year of massive flooding and little comment (let alone financial help) from the government.

### **Conclusion**

With the CCP having funded Iran in order to indirectly fund Hamas, thus being somewhat responsible for the latest attack on Israel, it would appear that China is targeting all countries with connections to the US in one way or another so as to test the resolve of the US. The real question is, if there is a real ‘raw nerve’ in the region that would genuinely fire up US government’s temper or has China’s long-term unrestricted warfare plan finally eroded America to the point of servitude.

## **GREY AREA DYNAMICS**

Over the years, KCS has made it their business to find workable solutions to impossible problems. To do this, KCS has sought to establish clearly the intelligence gap between perception and reality.

In today's market where terrorism, organised crime, cybercrime and government sponsored cyber espionage and war appear to confront us daily, we need reliable tools to identify the risks well in advance. It was for these reasons that KCS created and developed the analysis of risk by Grey Area Dynamics or GAD's, as they are often referred.

GAD's are all the risks, weakness and threats that will, at one time or another, interfere, disrupt or at worst close down businesses. In the projects and work in which KCS have been involved in all over the world, it has been evident that the GAD's identified, can and do kill. This method of risk assessment and measurement goes well beyond standard due diligence and is a collective description of factors, which can be passive and non-passive, legal and illegal. Because GAD's are difficult to quantify or assess from a purely economic viewpoint, these considerations do not normally feature in most credit ratings, investment and banking reports, which focus only on sovereign risk.

The main categories of Grey Area Dynamics usually encountered are:

### **Passive/Legal**

- Language & Dialects
- Local Customs & Traditions
- Local Staff – motivation and training
- Tribalism and Integration
- Cultural & Local sentiment
- Regulations, Taxes and Duties
- Currency & Capital exposure – payment methods and banking practice
- Environmental Hazards
- Pressure Groups
- Media Relations



**Non-Passive/Legal**

- Industrial & Labour Relations
- Absence or effectiveness of Legal Safeguards
- Government Policy and Nationalisation
- Overt and disguised/beneficial ownership
- Bureaucracy and Local Government
- Public or Media hostility

**Passive/Illegal**

- Bribery & Corruption
- Vested Interests and Cronyism
- Patronage
- Product diversion
- Parallel Trading
- Hidden Barriers to entry

**Non-Passive/Illegal**

- Counterfeit & Fraud
- Pilferage
- Unfair Market Competition
- Product Piracy
- Ethics and Corporate Espionage
- Organised Crime
- Threats to physical assets
- Kidnap & Extortion
- Religious Extremism
- Terrorism
- Civil Unrest
- Product Contamination

For a risk assessment to be thorough, it must encompass the potential for a broad array of economic, political and business situations that might affect a business venture. Evaluations limited just to political issues or financial factors may be completely misleading.

The degree of severity of a risk portfolio will also depend on the origin of the investing entity; for example, European companies often face different risk profiles to American corporations considering the same investment opportunity.

Grey Area Dynamics pose a challenge of diagnosis<sup>1</sup>. The key to avoiding problems before they occur or solving them after they have begun to take a toll on performance, lies in their early identification and evaluation. Ignoring the impact of GAD's can be a costly business.

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<sup>1</sup> KCS Group Europe won the European Service Provider of the Year, 1999-2000 at the European Risk Management Awards magazine International Risk Management for their work on GAD's. In 2004, the company won an award for Product of the Year from StrategicRisk.