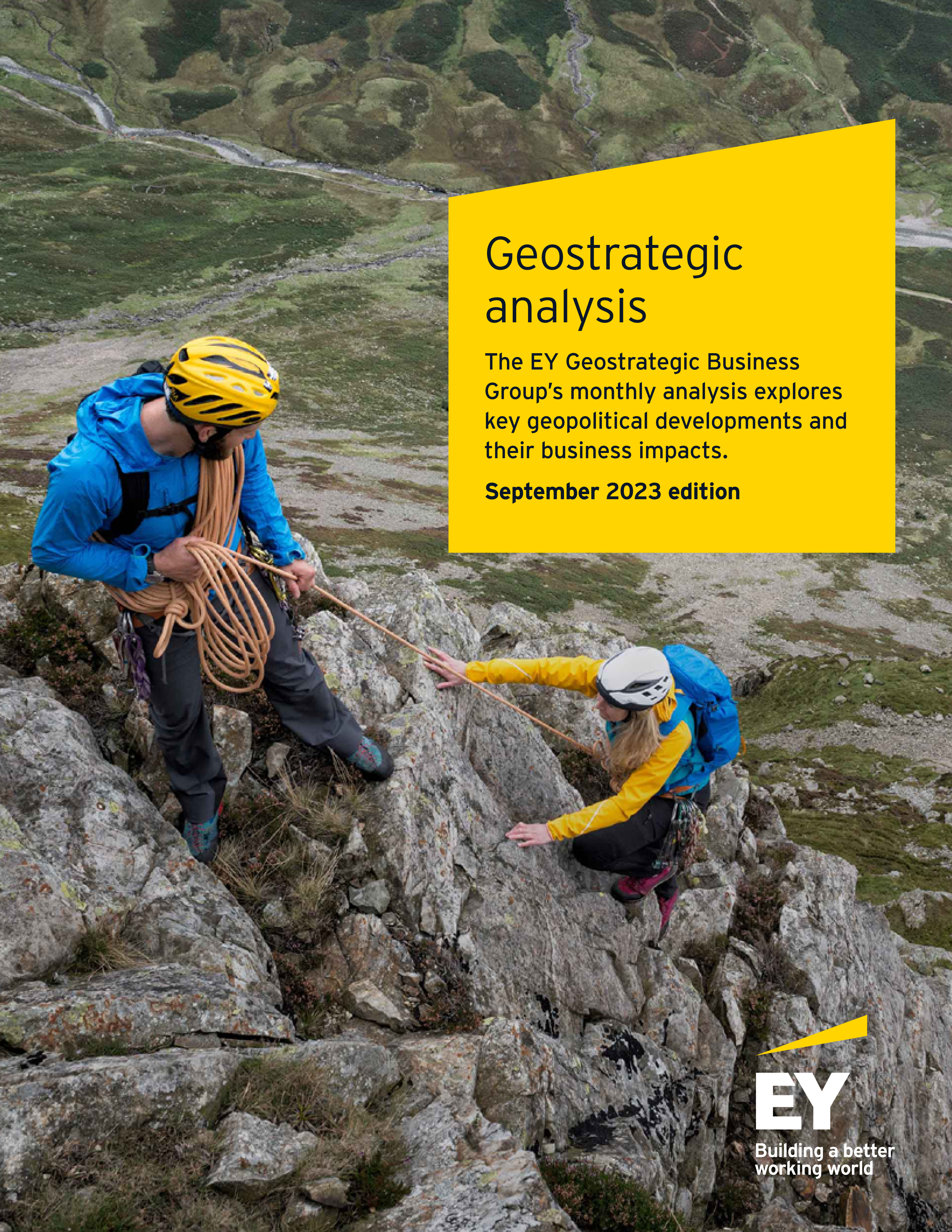
Geostrategic analysis

The EY Geostrategic Business Group's monthly analysis explores key geopolitical developments and their business impacts.

September 2023 edition



Building a better working world

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EY Geostrategic Business Group (GBG)
Translating geopolitical insights into business strategy

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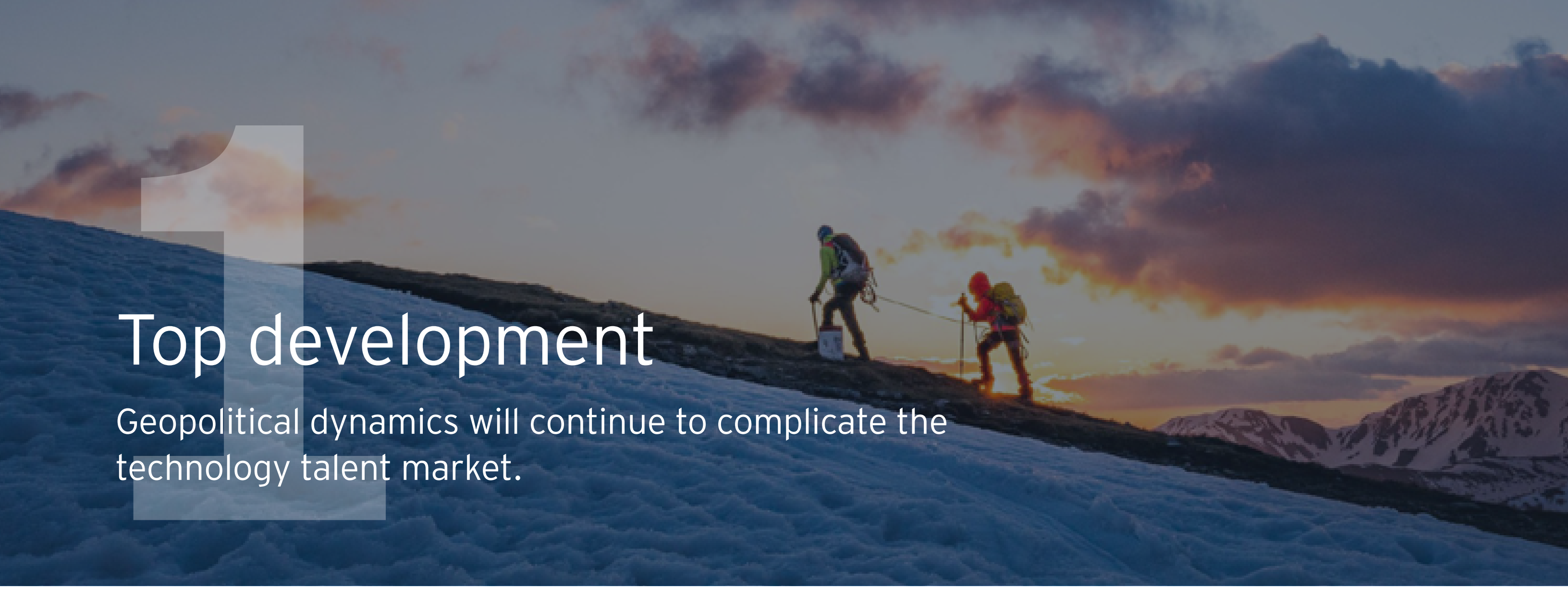

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Top development

Geopolitical dynamics will continue to complicate the technology talent market.

What happened

Amid increasing global geopolitical competition in strategic technologies, many economies have highlighted global science and engineering talent as key to national security and economic growth.[1,2,3]

Dutch universities imposed restrictions on technology students receiving China-sponsored scholarships and the government announced it is planning legislation to screen students from outside the EU studying in technical fields.[4]

In October 2022, the US introduced a ban[5] on US persons working for targeted Chinese technology companies. In addition, the number of US visas granted to Chinese students fell 45% in 2022 compared to 2021.[6]

In February 2023, the EU prohibited[7] Russian nationals from holding any post in the governing bodies of entities operating in critical infrastructure and other sectors including banking and public administration.

What's next

The US and European countries will likely continue to tighten security screening and controls of talent in education, technology and critical infrastructure. This could intensify labor shortages in fields such as engineering, data science and advanced manufacturing.

For instance, the Netherlands plans to introduce a "Knowledge Security Screening Law" in 2025 to limit non-EU students' access to domestic technology education programs. Sweden[8] and Australia[9] are discussing stricter security checks to screen foreign talent.

The EU and the US are boosting investments to reskill and upskill their working population, as well as to create technology skills hubs at home to attract innovative businesses. Together with allies and partners, including India and Japan, they will also work to share best practices and establish new industry standards.[10, 11]

As part of China's efforts to expand and deepen domestic scientific research and technological innovation, Beijing is planning to invest more in science and technology universities and in talent training programs for basic research. The government will likely seek to mobilize both foreign and Chinese technology talent.[12]

Policymakers around the world may try to oblige companies to onshore more workers to reduce the risks of industrial espionage in strategic sectors. However, persistent talent shortages and suitability of technology occupations such as data engineering and software development for remote work is also likely to drive companies to nearshore such talent.

Even as governments introduce measures to attract key technology talent — particularly on artificial intelligence (AI) — into their economies, regulations are also likely to increase to balance against perceived national security risks.

Business impact

Major sectors affected include technology, infrastructure and education.

Western-based education institutions are likely to face increased pressure to implement security screening for applicants on the basis of nationality, as well as restraints on the number of visas granted to foreign students. This could pose revenue challenges for some institutions.

Government measures in the EU and the US will continue to impact hiring by companies in the strategic technology and critical infrastructure sectors to domestic citizens or individuals not affiliated with perceived geostrategic competitors. This may exacerbate existing labor shortages in these sectors.

Companies in China face a shortage of chip-making talent in the near term and those graduating may lack hands-on experience with leading chip technologies. The talent market is likely to improve in the medium to long term as more university students earn science and technology degrees.

All companies should assess and manage the impacts of talent policies on business operations and cybersecurity in key markets. Companies can mitigate the impact of talent shortages by taking advantage of onshoring incentives, expanding reskilling programs and drawing on the pool of tech-skilled workers in emerging regional hubs.

For more information, contact Famke Krumbmüller, Seema Farazi, Grantley Morgan.

Additional reading: How can reimagined mobility help organizations see reward and not risk?

[1] Remarks by National Security Advisor Jake Sullivan at the Special Competitive Studies Project Global Emerging Technologies Summit | The White House https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/09/16/remarks-by-national-security-advisor-jake-sullivan-at-the-special-competitive-studies-project-global-emerging-technologies-summit/

[2] An EU approach to enhance economic security | Europa.eu https://ec.europa.eu/commission/presscorner/detail/ en/ip_23_3358

[3] Xi Jinping calls for strengthening basic research to solidify self-reliance in science and technology - Ministry of Education of the People's Republic of China | moe.gov.cn http://en.moe.gov.cn/news/media_highlights/202302/t20230224_1047553.html

[4] Online consultation starts on proposed legislation concerning internationalisation of higher education | Netherlands Ministry of Education, Culture and Science https://www.government.nl/ministries/ministry-of-education-culture-and-science/news/2023/07/14/online-consultation-starts-on-proposed-legislation-concerning-internationalisation-of-higher-education

[5] Commerce Implements New Export Controls on Advanced Computing and Semiconductor Manufacturing Items to the People's Republic of China | US Department of Commerce https://eycanada.sharepoint.com/sites/EYGBG/Shared Documents/Insights/01.0 Geostrategic Analysis/2023_09 Geo Analysis/file (doc.gov) https:/www.bis.doc.gov/index.php/documents/about-bis/newsroom/press-releases/3158-2022-10-07-bis-press-release-advanced-computing-and-semiconductor-manufacturing-controls-final/file

[6] Number of New Chinese Students at U.S. Colleges Plummeted This Fall, Visa Data Show | The Chronicle of Higher Education https://www.chronicle.com/article/number-of-new-chinese-students-at-u-s-colleges-plummeted-this-fall-visa-data-show

[7] Overview of the EU's 10th sanctions package in relation to Russia | White & Case LLP | whitecase.com https://www.whitecase.com/insight-alert/overview-eus-10th-sanctions-package-relation-russia

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[10] First EU-India Trade and Technology Council | europa.eu https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2728

[11] FACT SHEET: Quad Leaders' Tokyo Summit 2022 | The White House https://www.whitehouse.gov/briefing-room/statements-releases/2022/05/23/fact-sheet-quad-leaders-tokyo-summit-2022/

[12] Full Report to the 20th National Congress of the Communist Party of China | China Ministry of Foreign Affairs https://www.fmprc.gov.cn/eng/zxxx_662805/202210/t20221025_10791908.html

Sector in focus: Private Equity

US outbound investment restrictions will complicate cross-border investment efforts.

What happened

In August, the Biden Administration signed an executive order to restrict outbound investment in China, requiring disclosure of certain transactions and fully prohibiting others in strategic sectors, which are semiconductors, quantum computing, and artificial intelligence.[13]

Proposed covered investments include joint ventures, greenfield investments, acquisition of equity interests, and debt convertible to equity.[14] Exemptions are expected for publicly traded security investments, and for passive limited partner investments under a certain threshold.

What's next

Rulemaking to define the ultimate scope and boundaries of covered transactions and sectors is expected to be complex, with opportunities for industry input. Additional US policymaking to expand notification requirements and targeted sectors remains a possibility.[15]

While uncertainty remains around potential perceived countermeasures by Beijing — such as restrictions placed on exports of critical minerals announced earlier this year — US allies, including the UK and the EU, are expected to consider similar restrictions in the coming months.

Business impact

Companies and investment firms should monitor outbound investment policies in the US, and plans in the UK and the EU, and develop greater political risk management and compliance capabilities to both influence and comply with final requirements.

Private-equity and venture capital funds, in addition to companies seeking joint ventures or other investments will fall under increasing scrutiny by US authorities in relation to investments in China and should evaluate their portfolio investments and allocations in light of the regulatory, geopolitical and macroeconomic environments.

For more information, contact Adam L Barbina and Amar C Mehta.

Additional reading: Three ways CFOs are adapting to emerging private equity trends

[13] Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern | The White House https://www.whitehouse.gov/briefing room/presidential-actions/2023/08/09/executive-order-on-addressing-united-states-investments-in-certain-national-security-technologies-and-products-in-countries-of-concern/
[14] Outbound Fact Sheet | US Treasury.gov https://home.treasury.gov/system/files/206/Outbound-Fact-Sheet.pdf
[15] Biden's China Order Raises Tough Questions for Private Equity - WSJ https://www.wsj.com/articles/bidens-china-order-raises-tough-questions-for-private-equity-e1b8b71#:~:text=Along%20 with%20prohibiting%20some%20private,information%20after%20they%20provide%20it.

3 Other issues we are watching

BRICS expansion efforts further evidence of geopolitical shifts

The BRICS summit in August led to announcement of the largest expansion of the political and economic bloc since its formation, including Argentina, Egypt, Ethiopia, Iran, Saudi Arabia and the United Arab Emirates.[16] Divisions among members are likely to moderate or slow some stated goals as the group pursues enhanced autonomy from perceived Western geopolitical dominance. Still, consideration of expanded use of local currencies for trade and lending, rather than the US dollar, will now carry greater consequence for global trade.[17]

Business impact: Companies operating in or trading with BRICS markets need to be more attuned to strategic and supply chain impacts as geopolitical relations shift toward a multipolar world. Businesses should consider how to manage potential foreign exchange risk if trade in local currencies expands. In addition, executives should include geopolitical risk assessments in their M&A diligence for transactions involving BRICS markets.

For more information, contact Jay Young and Ben-Ari Boukai.

Corporate taxation changes to address economic challenges facing European countries

Amidst rising living costs, the Italian government announced in August a one-off windfall profit tax – pending parliamentary approval – to redistribute banks' extra revenues from higher interest rates.[18] Similarly, other European countries have increased, and are planning to further expand, corporate taxation to pay for government-funded relief for households coping with high inflation and energy prices triggered by the war in Ukraine and other factors.[19] For instance, taxes on energy companies have been extended in Spain, Slovakia, Hungary and the Czech Republic. This contrasts with attempts of countries like Germany, which are attempting to revive slowing economic growth through tax cuts.[20]

Business impact: As anticipated in the EY 2023 Geostrategic Outlook, the variety of challenges faced by governments from the "energy security imperative" and "inflation-recession paradox" are requiring policy trade-offs, including more volatile corporate taxation in Europe, to support near and longer term objectives. While so far, governments have limited tax increases to the energy, finance, food, and pharmaceutical sectors with perceived excess profits, companies should assess their exposure to higher tax burdens, especially in higher-than-average profit sectors, and for the possibility of these measures for a longer duration.

For more information, contact Famke Krumbmüller.

Niger and Gabon coups reflect broader regional security and geopolitical risks

On 26 July, a military junta overthrew President Mohamed Bazoum of Niger, reflecting ongoing challenges from economic malaise, rising extremism and migration concerns. Efforts by the Economic Community of West African States (ECOWAS) to negotiate a return to democratic rule have not yielded results thus far. Little over a month later, military officials in Gabon seized power following disputed election results to end the president's family's decades-long rule.

Business impact: The instability in Niger and Gabon has raised concerns about "coup contagion" in neighboring countries, which could impact the economic reform agendas in Nigeria and Ghana. Pronounced economic slowdowns, potential Western sanctions and reduced investor confidence will further hinder access to capital in the countries and West and Central Africa, leaving industries reliant on consumer demand and international trade and investment (e.g., agriculture, manufacturing, tourism, automotive) particularly vulnerable. Political instability could also impact exports of minerals (uranium, manganese) and oil.

For more information, contact Hulisani Muloiwa and Angelika Goliger.

[16] XI BRICS Summit Johannesburg II Declaration | BRICS 2023 https://brics2023.gov.za/wp-content/uploads/2023/08/Jhb-II-Declaration-24-August-2023-1.pdf
[17] Brics bank strives to reduce reliance on the dollar | Financial Times (ft.com) https://www.ft.com/content/1c5c6890-3698-4f5d-8290-91441573338a
[18] Italian government softens shock 40 percent | Politico.eu https://www.politico.eu/article/italian-government-softens-shock-40-percent-bank-tax/
[19] Europe's thriving businesses face mounting windfall tax hit | Financial Times (ft.com) https://www.ft.com/content/c16fdb5d-ec8a-44bd-a482-ff9c50719c3c
[20] Germany agrees 32 bln euro tax cuts to give economy 'big boost' | Reuters https://www.reuters.com/world/europe/germany-agrees-7-bln-euro-tax-cut-boost-flagging-economy-2023-08-29/

Geostrategic indicator of the month

FDI between geographically and geopolitically close countries

The indicator

Geopolitical distance is a measure of how countries' voting patterns in the UN General Assembly align, which serves as a proxy for how close countries are in terms of their foreign policies and stances on international issues. Recent geopolitical events have accelerated a shift toward a multipolar world, which narrows the geopolitical distance among countries in the same bloc or alliance while widening the distance between blocs.

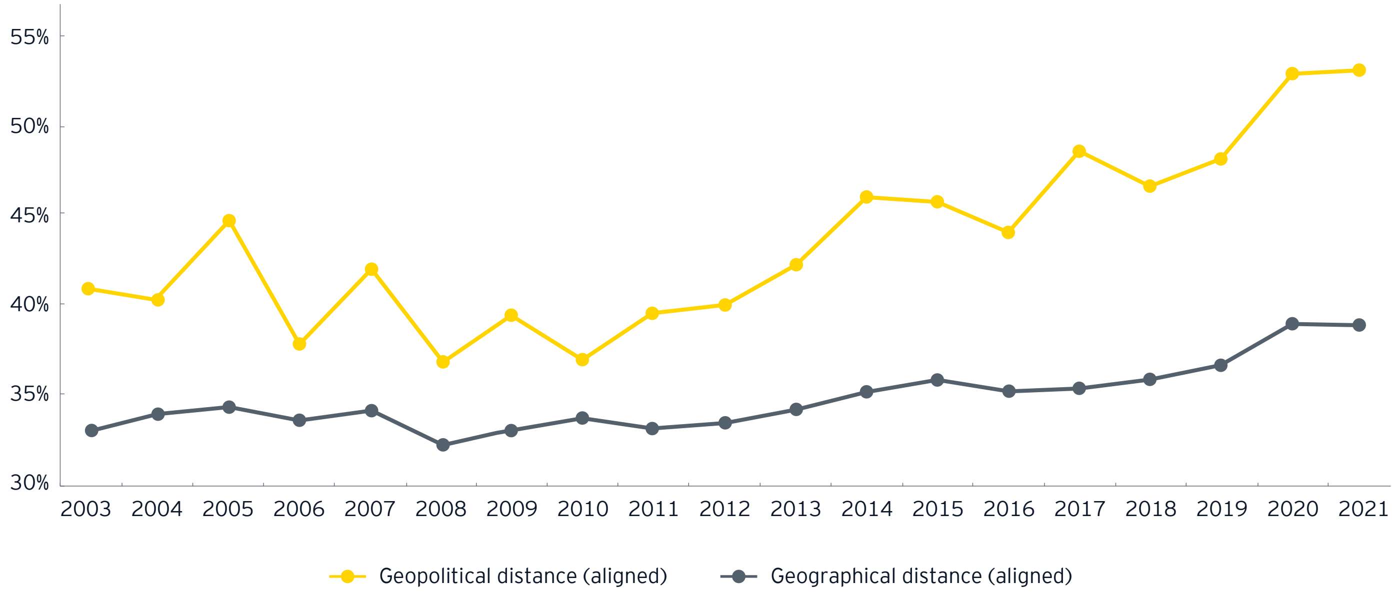
Business impact

As widening geopolitical gulfs lead to more limitations on and disincentives for cross-border investment , companies are likely to have fewer merger and acquisition (M&A) or investment opportunities between geopolitically distant countries. At the same time, markets that are geopolitical close to a company's home country may offer more opportunities. The same will likely be true for supply chains as well, with companies adjusting their trade and supply chain relationships to operate within markets that are geopolitically close to their home country.

Additional reading: The CEO Imperative: How will the shifting world order affect your global strategy?

Geopolitical considerations appear to be increasingly driving cross-border investment decisions

Foreign direct investment (FDI) between geographically and geopolitically close countries (percent)



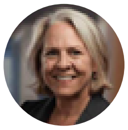
Note: The graph shows the annual share of total FDI between country pairs that are similarly distant (that is, in the same quintile of distance distribution), geopolitically and geographically, from the US.

Source: International Monetary Fund, World Economic Outlook, April 2023, https://www.imf.org/en/Publications/WEO/Issues/2023/04/11/world-economic-outlook-april-2023.
Note: The graph shows the annual share of total FDI between country pairs that are similarly distant (that is, in the same quintile of distance distribution), geopolitically and geographically, from the US.

Contacts

Oliver Jones
London
oliver.jones@uk.ey.com

Angelika Goliger
Johannesburg
angelika.s.goliger@za.ey.com



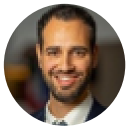
Mary Karol Cline
Washington DC
mary.k.cline@ey.com

Courtney Rickert McCaffrey
Washington DC
courtney.r.mccaffrey@ey.com

Adam Barbina
New York
adam.l.barbina@parthenon.ey.com

Ari B. Saks Gonzalez
Mexico City
ari.b.saks.gonzalez@mx.ey.com

Douglas Bell
Washington DC
douglas.m.bell@ey.com



Ben-Ari Boukai
Washington DC
ben-ari.boukai@parthenon.ey.com

Jay Young
Dallas
jay.young1@parthenon.ey.com

Famke Krumbmüller
Paris
famke.krumbmuller@parthenon.ey.com

Takeshi Konomi
Tokyo
takeshi.konomi@parthenon.ey.com

David Kirsch
Houston
david.e.kirsch@ey.com

Nobuko Kobayashi
Tokyo
nobuko.kobayashi@parthenon.ey.com

Alessandro Faini
Paris
alessandro.faini@parthenon.ey.com

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