The New Geostrategic Pressure Point

By Louis-Vincent Gave

Millennia of evolution have biased humans to focus disproportionately on scary experiences and to remember them far more acutely than less frightening events. No doubt this bias goes back to the days when every time we left our caves, we risked being eaten by a saber-toothed tiger (or being clubbed over the head by a hostile Neanderthal).

Today, such risks are remote. Nevertheless, when traumatic events happen, they still leave deep scars on our collective psyche. For example, ask any investor what was the most important event of 2001, and the answer is likely to be the terrorist attacks on the World Trade Center and Pentagon. Yet with hindsight, the key event of 2001 for investors was China’s entry into the World Trade Organization.

Similarly, investors today are focused overwhelmingly on the economic impact of the coronavirus pandemic and the effects of the U.S. presidential election. Yet something happened over the summer that, although not at all traumatic by comparison, may end up having much more far-reaching consequences for world geopolitics. Yet few seemed to comment or care.

The event was a contrasting pair of corporate announcements. In July 2020, Intel, the U.S. company that was once the unchallenged global leader in semiconductor manufacturing, announced that it will not be able to mass produce 7-nanometer (nm) chips until 2023, some 18 months later than its original guidance. Then just weeks later, Taiwan Semiconductor Manufacturing Firm (TSMC), which is already producing at 7 nm, confirmed that it will begin mass producing 3-nm chips in 2022.

In a nutshell, this means that the once-dominant Intel has lost its technological edge over TSMC and is unlikely to regain it before 2025 at the earliest—if ever. And if you are tempted to dismiss this as hyperbole, figure 1 shows the market capitalizations of both Intel and TSMC, and it drives home the pronounced divergence that took place between them over the summer.

On the topic of divergences in market cap, figure 2 compares the market capitalization of the global semiconductor sector with the market cap of the global energy sector. In essence, this weighs the key commodity of the information age against the vital commodity of the industrial age; for the first time in history, the global semiconductor industry is now larger—and meaningfully larger—than the global energy industry.

Any geopolitical analyst contemplating figures 1 and 2 will be compelled to ask two key questions. Will the unstable geopolitical fault lines of the future still...
run through the Middle East, as they have since the 1973 oil crisis and the fall six years later of the Shah of Iran? Or will the critical global geostrategic fault line of the future instead shift dramatically to the Taiwan Strait?

Of course, Taiwan has long figured as a source of potential instability in the relationship between the United States and China. But that was at a time (1) when the United States and China got along, first in the Henry Kissinger-Zhou Enlai era as allies arrayed against the Soviet Union, then as economic partners in the “Chimerica” era; and (2) when in the grand scheme of things, Taiwan was nowhere near as central to the global supply chain as it is today.

But if you accept—as the market clearly does—that in the world of today, and even more in the world of tomorrow, semiconductors matter more than oil, then it is logical to conclude that in geopolitical terms, Taiwan is now more important than Saudi Arabia.

What’s more, Taiwan threatens to be even more problematic than Saudi Arabia, given the recent deterioration in the U.S.-China relationship and Beijing’s insistence that Taiwan is not a separate country but an integral—if wayward—part of the motherland.

Putting all this together, the passing of the baton of technological leadership from Intel to TSMC could hardly have happened at a worse time. The U.S. response to this development is likely to be more weapons sales to Taiwan—indeed these already are promised—and possibly even the promise of military protection. And this, coming on top of the U.S. restrictions on technology sales to Chinese companies including Huawei, ZTE, and SMIC, inevitably will go over like a lead balloon in Beijing.

So how will China respond? The first order of business is for Beijing to continue to invest in its semiconductor industry in a bid to close the technology gap. My colleagues Dan Wang of Gavekal Dragonomics and Matt Forney of Gavekal Fathom China have researched this in detail over the past year, and there are no reasons to believe the trend will do anything but accelerate.

The second order of business for China will be to keep investing in its military. On this note, there are solid historical correlations between strong militaries and strong tech sectors. In today’s world, you find strong tech sectors in the United States, which has the biggest defense budget in the world; in China, with the second biggest military budget; in Japan, which for years boasted the highest defense spending in Asia; and in Israel, South Korea, and Taiwan, all of which have large defense budgets relative to gross domestic product. In contrast, countries that used to spend on their militaries but no longer do, such as France and the United Kingdom, typically have seen their tech sectors shrivel and die, with the eclipse of once proud national tech champions such as Alcatel and Marconi.

The third order of business for China will be to ratchet up its cross-strait rhetoric—with the obvious consequence that companies and individuals will begin to think twice before investing more in Taiwan and may even reassess their dependence on Taiwanese-made components.

At the very least, these developments will mean that a generation of geopolitical analysts who have spent their entire careers scrutinizing every tiny shift in the sands of the greater Persian Gulf region will now have to refocus their telescopes on the Taiwan Strait instead.

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