

MARKET SIGHT LINES



More U.S. - China Tensions: What might happen with Taiwan?

By Michael O'Keeffe, *Chief Investment Officer*



In our [Outlook 2022: Balancing Acts](#), we wrote about U.S.-China competition and related tensions, covering topics like pandemic response, technology, economic alliances, tensions in the South China Sea, and the prospect of a “New Cold War” with China and Russia. Our technology discussion included a focus on semiconductors, which brings to mind, of course, the important role played by Taiwan in semiconductor production. In this week’s Sight|Lines, we focus on increasing U.S.-China tensions and address the question: What might happen with Taiwan?

A VERY SHORT HISTORY OF TAIWAN

Intermittently between 1927 and 1949, the Kuomintang (KMT)-led government of the Republic of China (ROC) and forces of the Chinese Communist Party (CCP) were engaged in the Chinese Civil War. In 1949, the CCP gained control of mainland China and established the People’s Republic of China (PRC), forcing the leadership of the ROC to flee to the island of Taiwan. Since the 1950s, the ROC in Taiwan and the PRC in mainland China have been in a standoff, with both officially claiming to be the legitimate government of all of China. Both sides engaged in sporadic conflict beginning with the 1958 Taiwan Strait Crisis until both sides ceased fire in 1979, but with no official peace treaty.

Taiwan has been governed independently since 1949, with its own constitution, democratically-elected leaders, and active armed forces. The PRC's official view is that Taiwan is a renegade province, and Chinese President Xi Jinping has said “reunification” with Taiwan “must be fulfilled.”

CHINA-TAIWAN ECONOMIC RELATIONS

Given their proximity and historical connections, it makes sense that China remains an important trading partner to Taiwan, especially in cross-strait trade. China is Taiwan’s largest trading partner, with almost 30% of Taiwan’s exports going to mainland China. Trade with China accounted for about 12% of Taiwan’s GDP in 2021.

Technology is an important sector for Taiwan. About 70% of Taiwan’s exports to China are technology related. Comparatively, only about 0.4% of Taiwan’s exports to China are food items. Notably, China recently restricted shipments from many of Taiwan’s food exporters, presumably as a political statement in advance of U.S. Speaker of the House Nancy Pelosi’s recent visit, but also as one in a series of measures taken by Beijing that target Taiwan’s agricultural regions known to support President Tsai Ing-wen and her Democratic Progressive Party.

WHY ARE TENSIONS HIGHER NOW?

China-Taiwan tensions have increased since President Tsai's election in 2016. She maintains that a "consensus" was never reached by both sides at a 1992 summit meeting, and she rejects the "one country, two systems" principle proposed by the PRC government for Taiwan. China responded, suspending official cross-strait communications, restricting mainland tourist visits to Taiwan, and increasing the patrols of bombers, fighter jets, and surveillance aircraft around and over Taiwan. As mentioned, China also responded negatively to Speaker Pelosi's recent visit to the island.

THE U.S. POSITION – SOME SUPPORT FOR TAIWAN

The U.S. seeks to maintain peace and stability in the Taiwan Strait, supporting the status quo. The U.S. does not formally recognize Taiwan's independence and, for many years, has tried to maintain a balance of supporting Taiwan while not overly aggravating China. Then President-elect Trump spoke with President Tsai by telephone ahead of his inauguration, representing the highest level of contact between the two sides since 1979. His administration supported Taiwan, for example selling it more than \$18 billion of military equipment. Taiwanese representatives were invited by then President-elect Biden to his presidential inauguration. And during both the Trump and Biden administrations, numerous U.S. officials have visited Taiwan.

TAIWAN'S ROLE IN THE GLOBAL ECONOMY

While Taiwan produces only about 1% of global GDP, its role in the global economy is critical. The Taiwan Semiconductor Manufacturing Company (TSMC) produces the majority of the world's most advanced semiconductors. So, Taiwan plays a key role in the world's supply chains.

WHAT MIGHT HAPPEN WITH TAIWAN? IS A WAR INEVITABLE?

China has not ruled out the use force to achieve Taiwanese "reunification." The U.S. has not ruled out defending Taiwan if China chooses to attack. Some experts believe that an invasion could happen over the next decade, while others suggest such an action could occur later as part of China President Xi's "Chinese Dream" to become a fully developed nation by about 2049, the 100th anniversary of the founding of the People's Republic.

We maintain the view that an invasion isn't imminent, as China is not interested in disrupting Taiwan's role in the global technology economy, especially after witnessing the world's response to Russia's invasion of Ukraine. That said, we should expect China's tone to remain aggressive and for tensions to remain elevated in the region.

CONCLUSION

Taiwan plays a critical role in the world's supply chains, especially with respect to semiconductors. Tensions remain elevated there, with China upset about the U.S.' increasing support for Taiwan since 2016. And while tensions and China rhetoric may well remain elevated, we don't see a China invasion of Taiwan any time soon.

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