

WEEKLY ECONOMIC COMMENTARY | JANUARY 19, 2024

# TAIWAN'S ELECTIONS AMID ASCENDING TENSIONS

Taiwan and China have a fierce political rivalry, but are closely linked through trade and investment.

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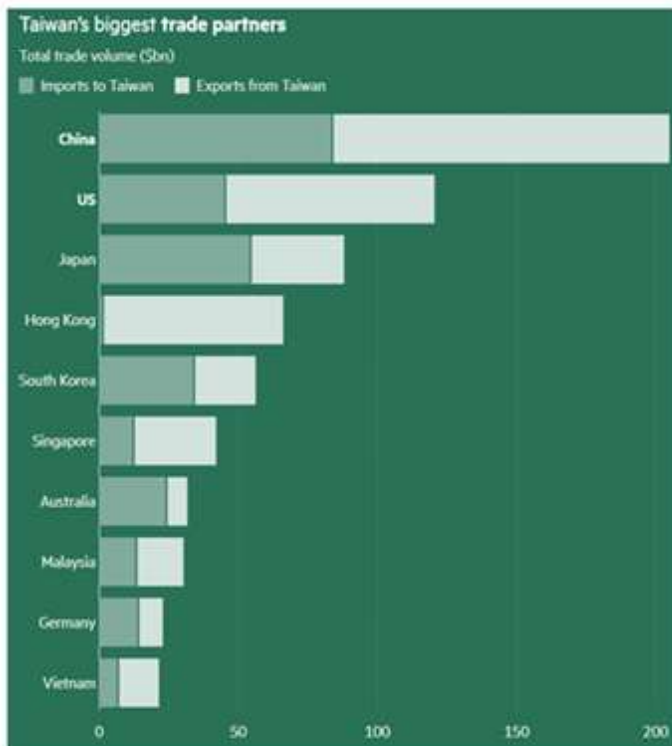
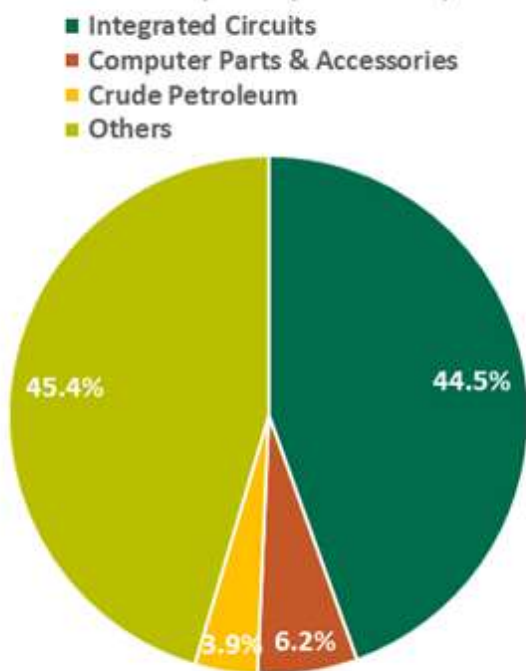
By Vaibhav Tandon

If investors, businesses and observers thought that 2023 was a year of geopolitical stress, an even more complex environment is on the horizon. Over 50 nations hold national or regional elections in 2024. Taiwan was the first significant market to go to the polls last Saturday, with important effect.

Some elections tend to have implications only for the domestic populace and the local economy. But the world closely watched the election in Taiwan, a small island of just 24 million residents. The attention was not founded on concern over the democratic process or the state of the local economy, but rather the simmering tensions in the Taiwan Strait.

Taiwan's disputed sovereignty is the root of the contention. Beijing seeks to formalize Taiwan as a Chinese territory, while the victorious party in last week's election, the Democratic Progressive Party, wants to increase the distance between the two. How these points of view get resolved will have critical implications for trade and security around the world.

### Taiwan Exports (% of Total)



Sources: Taiwan Customs, ING, FT

## TAIWAN AND MAINLAND CHINA HAVE A LOVE-HATE RELATIONSHIP.

Taiwan is a highly open economy, with exports as its main engine of economic growth. Though the island is only the world's 17<sup>th</sup> largest exporter of goods, it has an outsized impact on global commerce and politics. Semiconductors are the pillar of their economy. According to estimates by the Rhodium Group, Taiwan manufactures over 60% of the world's chips and around 90% of the most advanced ones.

Taiwan Semiconductor Manufacturing Corp. (TSMC) is the world's largest supplier of computer chips. Semiconductors or chips are used in the majority of electronic products, ranging from computers and cars to military weapon systems. All of this gives the island geopolitical influence far beyond its size and population.

Taiwan and the People's Republic of China have a complex history and a fierce political rivalry, but they are inextricably linked through trade and investment channels. Ironically, Taiwan's economic prosperity has come on the back of close economic ties with the mainland. Beijing buys about 30% of the island's exports, most of which are integrated circuits, solar cells and electronic components. China runs trade surpluses with major economies like the U.S. and Europe, but often runs large deficits with Taiwan. This shortfall totaled \$80.5 billion in 2023.

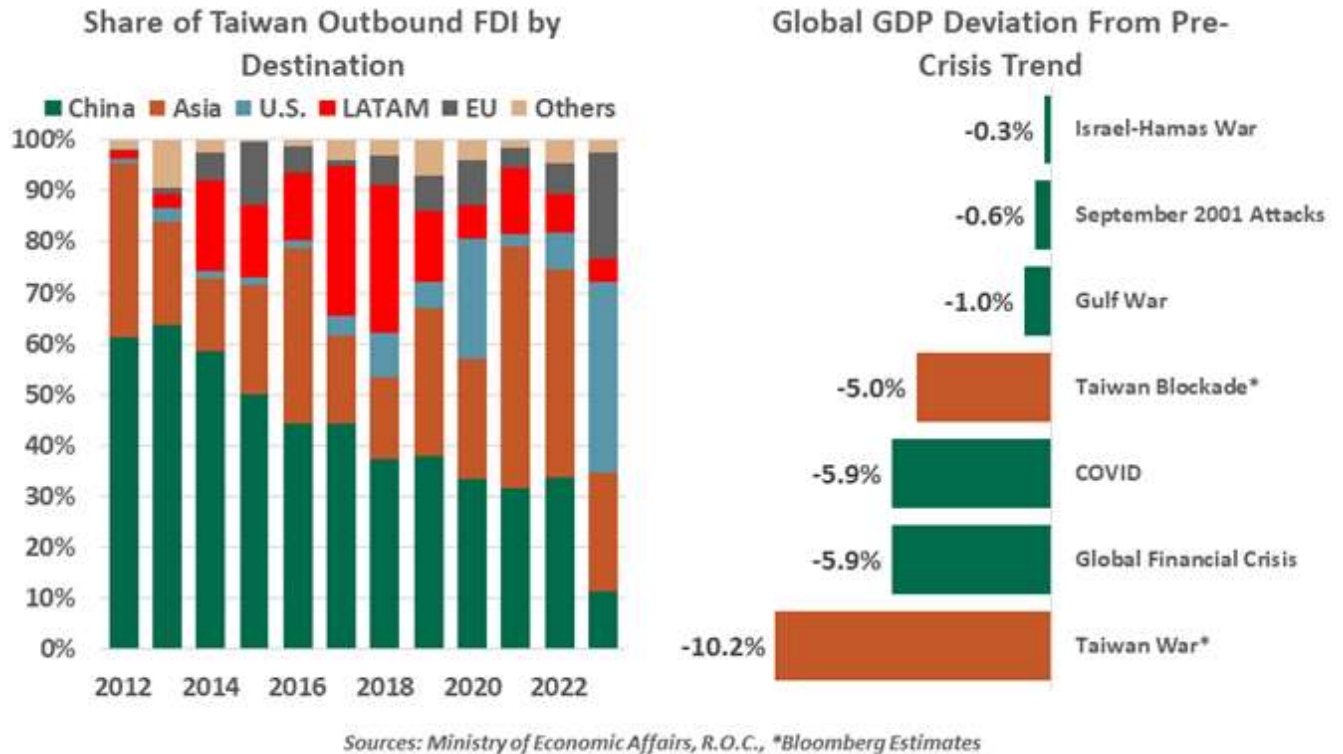
For Taiwanese businesses, the Chinese mainland has been the preferred investment destination for decades. Between 1991 and 2022, these firms invested a total of \$203 billion in China, creating millions of mainland jobs.

Even though trade with China continues to flourish, the Taiwanese government has been hedging its bets by boosting trade with the U.S. and the rest of Asia. The effort is aimed at de-risking and decoupling from the Chinese economy.

Amid regional frictions, TSMC has been shifting production to nations like Japan, Germany and the U.S. Taiwan's companies are also exploring options in India and Vietnam, which offer cheap labor and are not subject to any American tariffs.

Similar trends can be observed in cross-Strait investments, which fell bilaterally to new lows last year. Monies approved for mainland companies in Taiwan fell to \$30 million last year, down from the peak of \$350 million in 2013 and the lowest amount since the island started allowing Chinese investment about 15 years ago.

Taiwanese businesses have also become reluctant to invest in China; investment fell to about \$3 billion in 2023, the lowest since 2001. In 2010, over 80% of Taiwan's annual outbound investment flows went to mainland China. Last year, the share was 12%.



On the economic front, China has taken a series of actions in reaction to rising tensions and shifting alliances in the region. China has banned imports of hundreds of Taiwanese products, including vegetables, fruits and confections. Beijing also ended preferential tariffs on imports of Taiwanese products like chemicals, undoing part of a 2010 trade accord. These minor movements are unwelcome, but they are preferable to a wider escalation. A full economic blockage of Taiwan or a military invasion would have ripple effects across the world economy.

Russia's invasion of Ukraine showed that nations are inclined to respond first with economic sanctions against the aggressor. Any new tariffs or sanctions on mainland China would lead to massive economic consequences, as Beijing is far bigger and more integrated into global trade and financial systems than Moscow. A war over Taiwan would severely disrupt trade, as 60% of global sea trade passes through the South China Sea and the Straits of Malacca. According to Bloomberg Economics, this would lead to a loss of 6.7% of U.S. gross domestic product (GDP) in the first year and a 3.3% hit to its growth in the event of a full Taiwan blockade. This compares to a 2.2% contraction in 2020 due to the pandemic

## A FULL BLOCKADE OR WAR OVER TAIWAN WOULD HAVE MASSIVE SPILLOVERS ACROSS THE GLOBE.

According to the same analysis, a war between China and Taiwan would cost \$10 trillion, or about 10% of global GDP, an amount that would dwarf the blow from recent shocks like the Ukraine War, the pandemic and the 2008-09 financial crisis.

Heightened aggression would have serious implications for businesses on both sides. Taiwanese businesses had assets worth over \$40 billion in the mainland in 2022. The availability of the chips used in satellites, stealth jets and supercomputers would be severely disrupted, denting Beijing's "Made in China 2025" program and the ambition of modernizing its military by 2027. Cutting off supplies from Taiwan will end up hurting Chinese buyers more than Taiwanese businesses. Reshoring to move production away from this risky region [is underway](#), but the rest of the world is years away from replacing Taiwan's capacity.

Taiwan, considered a shining example of freedom, democracy and inclusivity, is at risk of becoming one of the major geopolitical flash points of our time. The Taiwanese people have spoken, and China did not welcome the message. As we outlined in our [Annual Outlook for 2024](#), a rotation in China and higher polarization in all nations have added to the risks of extreme outcomes. Perhaps the size of the stakes will keep the two sides from overplaying a bad hand.

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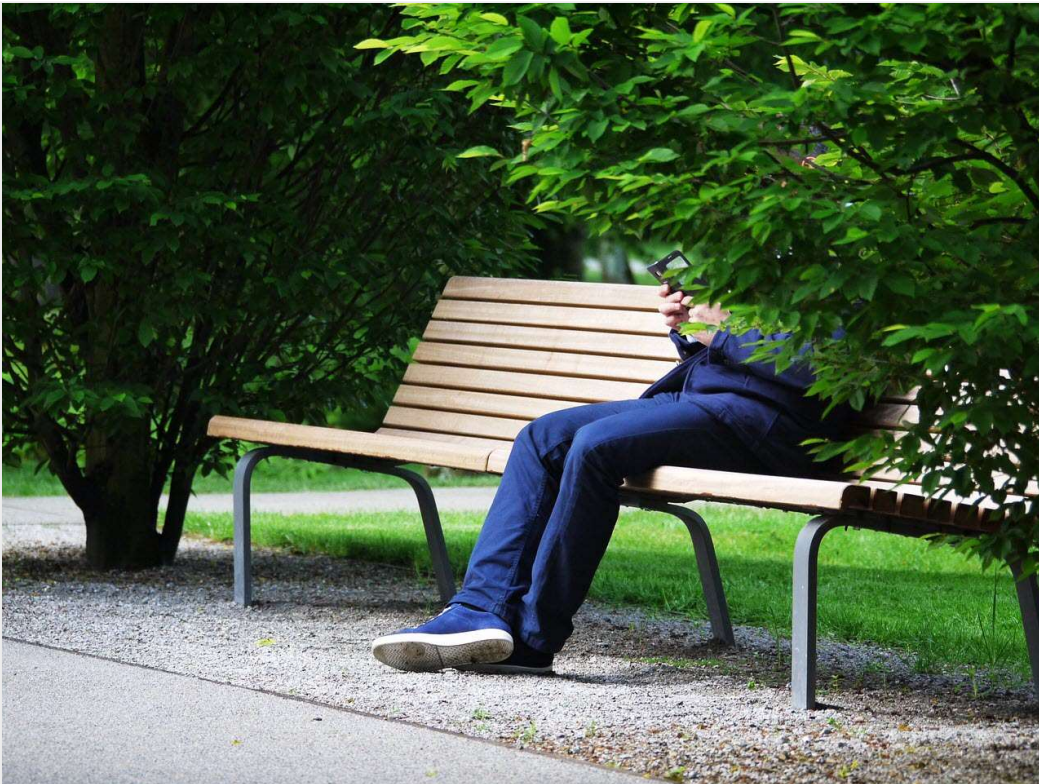


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