

CHINA RISKS: IS TAIWAN NEXT?



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There is growing concern among some commentators that China may be emboldened to invade Taiwan soon, given the lack of direct military support for Ukraine by the United States and NATO amid Russia's ongoing invasion. If the West won't go to war over Ukraine, why would they care about Taiwan? While a fair question, the odds of a Chinese invasion of Taiwan are still quite low over the next several years. There are major differences between Russia and Ukraine and China and Taiwan that make the current situation an imperfect analogy.

TAIWAN IS NOT UKRAINE

To oversimplify, Russia is invading to prevent Ukraine from joining the European Union and NATO. In Vladimir Putin's mind, a Western-aligned Ukraine in NATO poses a systemic risk to Russia and must be stopped and converted into a buffer-state like Belarus. Putin is willing to gamble on the invasion because Ukraine is not a member of NATO, meaning NATO has no formal obligation to defend Ukraine from military aggression. Additionally, Europe's reliance on Russian oil & gas makes a military response to the crisis in Ukraine unlikely.

Taiwan is fundamentally different. Taiwan is already aligned with the West (albeit in a form of diplomatic limbo) and the Taiwan Relations Act requires the United States to provide military support to Taiwan. While there is "strategic ambiguity" as to the extent of that support amid an invasion, the relationship between the United States and Taiwan is codified into US law, unlike the relationship with Ukraine.

While it is true that China views Taiwan as fundamentally a part of China (akin to how Putin views Ukraine as part of a wider historical Russia), the status quo between China and Taiwan has been in place for more than 70 years, which if maintained does not pose a systemic risk to China. In fact, the two economies have become increasingly intertwined over the past few years, and as recently as July 2021, Xi Jinping reaffirmed publicly that the People's Republic of China's stance toward Taiwan was "peaceful national unification."

Furthermore, there is debate among military analysts as to whether China currently has the military capability to successfully invade Taiwan. Taiwan is much better equipped than Ukraine and has been in a state of constant readiness for a Chinese invasion for decades. An amphibious invasion of Taiwan would be even more complex

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than the land-based invasion of Ukraine. Despite Russia's apparent military might, the Ukraine invasion is floundering so far, an observation surely not missed by Chinese leadership. A failed invasion of Taiwan would be damaging to the legitimacy of the Chinese Communist Party (CCP).

THE STAKES ARE HIGHER OVER TAIWAN

Another key difference is that the stakes for China invading Taiwan are much higher than for Russia invading Ukraine, something Putin has already done once and gotten away with in 2014 with the annexation of Crimea. While the invasion of Ukraine has impacted global commodity prices, neither Russia nor Ukraine are particularly integrated into the global economy.

A Chinese invasion of Taiwan would turn the South China Sea (and East China Sea between China and Japan) into a war zone. If the United States decided to intervene militarily, then Japan would likely join the conflict, as would other US allies in the region, such as South Korea and Australia, which all host US military bases and personnel in the region.

As a result, Asian trade would grind to a halt, which means global supply chains would further collapse because of China's role in global manufacturing and Taiwan's role in global semiconductor supply. This would likely occur even if the United States did not intervene militarily, given shipping routes would still be disrupted. The Chinese economy would be crippled by the trade shutdown and also by likely US sanctions. China still remains very reliant on US technology imports (especially advanced semiconductors) and the international banking system with much of China's trade (and FX reserves) still settled in US dollars and not RMB. This would be a global risk-off event, hitting US and European markets just as hard as Asian markets, with their exposure to multinational companies and banks.

A major economic downturn in China would risk domestic social stability and "common prosperity," and therefore threaten the legitimacy of the CCP, which is largely based on improving living standards. That assumes the invasion is successful. A failed invasion would be even more damaging for the Party.

CHINA'S PACIFIC NAVAL CORRIDOR ARCHITECTURE



Source: The International Institute for Strategic Studies.

Thus, for China to risk invading Taiwan, it needs to:

1. Have full confidence that it can succeed militarily;
2. Be sufficiently technologically independent from the United States;
3. Be sufficiently independent from the USD banking system; and
4. Have a compelling reason to justify the invasion (something must challenge the status quo).

In our assessment, none of the above conditions seem to be in place, even if China feels the US commitment to defend Taiwan is in doubt. Furthermore, the current sanctions on Russia, as well as Russia's current difficulty in the invasion, will make the naturally cautious Chinese authorities even more reluctant to invade until conditions 1 to 3 are fulfilled.

Indeed, modernizing the military, achieving technological self-sufficiency, and reducing reliance on the US dollar (or internationalizing the RMB) are all publicly stated strategic goals for China. China knows it is not ready and would not be willing to jeopardize the progress it has made by invading Taiwan in the near term. How long it will take for China to achieve these goals is difficult to say. Some analysts argue it will take over a decade to achieve technological independence if it can be achieved at all. Even the most hawkish US military analysts give a five-year window on China's ability to be militarily able to successfully invade Taiwan.

MAJOR CAVEAT: BREAKING THE STATUS QUO

There is one thing that would negate the logic stated above: Taiwan unilaterally declaring formal independence. If Taiwan were to break the status quo (either on its own or at the encouragement of the United States), then China would be forced to respond with some sort of attack, if not a full-fledged invasion, even if not fully ready. This is also for domestic political reasons; for 70+ years, this has been a stated promise. To not follow through would also undermine the Party. A failed invasion would be defensible domestically if the Taiwanese break the status quo.

So, what are the odds of Taiwan breaking the status quo? Given the Taiwanese will be the ones caught in the crossfire between China and the United States (or worse, on their own against China if the United States reneges), opinion polls regularly show the majority favors maintaining the status quo, even if other polls routinely show that most Taiwanese strongly oppose reunification with China and/or self-identify as "Taiwanese." Therefore, the most likely outcome is that the status quo remains. The benefit of formal independence versus the current de facto independence comes at a high potential cost, which is why the status quo has held for decades.

Nearly every Russia “expert” viewed a full-scale invasion of Ukraine as unlikely, based on the view that the potential economic and political damage was not worth it, and Putin was bluffing. But China is not Russia, and Xi is not Putin. For China to unilaterally break the status quo, risk a failed invasion, and inflict economic pain on the population would be extremely destabilizing for a Party that puts domestic stability above everything else. Given the current state of the Chinese economy and Xi’s upcoming third term, stability is the key word for 2022. Thus, the risk of China invading Taiwan this year, or any time soon, is low. ■

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