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CHINA VS. TAIWAN: HOW DID WE GET HERE?

By Eric Nager, CRPS®

We have long written about current events because they have such a great impact on the market. Few events have as dramatic effect on markets as wars. I clearly remember the sharp market drop when Iraq invaded Kuwait in 1990. Fortunately, it was a short-lived drop, since the U.S. intervened and ejected Iraq from Kuwait within six months.

Of course, some wars have a larger economic impact than others. The Iraq-Kuwait war was significant because it affected the supply of Middle East oil. By contrast, the war between Russia and Ukraine has had a relatively mild market impact. While the Ukrainian people are suffering terribly, Ukraine does not have a large economy. Russia is a major ex-

porter of natural gas and oil, but that production is not threatened by the war. While the market did drop when hostilities first broke out, a deal has just been reached with Russia whereby Ukraine is starting to export grain again to help alleviate the world food shortage.



Source: [businessinsider.com](https://www.businessinsider.com)

A war between China and Taiwan would be an entirely different matter. Taiwan produces half of the world's semiconductors on

which almost every technological device runs, from cars to computers, to cell phones. If that capacity fell into Chinese hands, or was destroyed or severely disrupted, the economic impact could be catastrophic. Because of this, it is important to know how the current tense situation came about.

Following World War II, China was ruled by a nationalistic government under the leadership of Chiang Kai-shek. He soon faced an insurgency from a communist group led by Mao Zedong and supported by the Soviet Union in what became the Chinese Civil War. By 1949, the communists drove the nationalists off the mainland, despite U.S. aid, and they retreated to the island of Formosa, now called Taiwan,

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where they formed their own government.

During much of the Cold War, the United States recognized Taiwan as the official government of China and pledged to come to Taiwan's aid if they were ever invaded by China. The relationship started to change in 1972 when President Nixon visited China in an attempt to woo them away from the Soviet Union. This diplomacy culminated in 1979 when President Carter recognized communist China as the official government but maintained "strategic ambiguity" with regard to aiding Taiwan. That meant that China could not be certain whether we would aid Taiwan or not.

Since then, most governments of the world have dropped their diplomatic recognition of Taiwan despite the fact that it enjoys a democratically elected government and a thriving free market economy. Most recently, tensions were aggravated when the U.S. Speaker of the House, Nancy Pelosi, became the highest ranking official to visit Taiwan in 25 years. This enraged the Chinese under President Xi Jinping, who is trying to consolidate his power and become the first leader since Mao to rule for more than two five-year terms. He plans to consolidate this power later this year and sees recognition of Taiwan as a threat.



For their part, the Taiwanese have observed with dismay how China has recently curbed promised freedoms in Hong Kong, the former British colony, and noted how China has promised to unite the country under one government by force if necessary. The recent visit by Mrs. Pelosi sparked Chinese live fire naval exercises in response that effectively blockaded Taiwan. The exercises could be practice for an invasion at some point. The question then becomes: Would the U.S. defend Taiwan?

In response to the live fire exercises, the U.S. dispatched the aircraft carrier *USS Ronald Reagan* to the area. However, China in recent years has greatly increased its naval capability and does pose a threat to U.S. ships. President Biden has stated more than once that the U.S. would defend Taiwan, but then also said that our policy of strategic ambiguity has not changed; so the answer is not clear. Congress recently passed a bill to encourage more domestic production of semiconductors, but it will take years before that production is online.

For now, it does not appear that an invasion is imminent. President Xi first wants to consolidate his power, and he is probably looking closely at the Russian war with Ukraine. At first, much of the world was united in condemning Russia for its act of aggression. Now, after several months of war, Russia is still able to sell oil and gas, and its economy is not suffering to a great extent. If Russia succeeds in annexing significant parts of Ukraine without serious conse-

quence, this could embolden Xi to invade Taiwan. On the other hand, if Russia is dealt a military setback and embarrassed on the world stage, it could give Xi pause. In any case, we will continue to monitor the situation closely and make investment adjustments as appropriate.

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Disconcerting Military Fact

In recent years, the Pentagon has found that about 76% of adults ages 17-24 are either too obese to qualify, have criminal histories, or other medical issues that would make them ineligible to serve in the U.S. military without a waiver. Source: Yahoo!

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