



# Global Macro Research - Insight

16 January 2024

9:57 minute read

#EM

/

#Geopolitics

/

#Scenarios

For professional and institutional investors only – not to be further circulated. In Switzerland for qualified investors only.

## Taiwan elections: status quo, not dire straits

Taiwan's elections results are unlikely to spark an escalation in cross-strait tensions. US elections pose the biggest threat to Taiwan and US-China relations via the future credibility of 'strategic ambiguity', although a fraught maintenance of the status quo remains the most likely outcome.

### Key Takeaways

- Victory for independence-leaning candidate Lai Ching-te in Taiwan's presidential election will likely mean cross-strait tensions remain somewhat elevated over the next few months.
- However, Lai's Democratic Progressive Party failed to win a majority in the legislature, tempering the election outcome from Beijing's perspective as the more Beijing-friendly opposition parties can potentially curtail some aspects of Lai's agenda.
- Both Lai and the US have sought to de-escalate tensions with Beijing, emphasising the maintenance of the status quo. Beijing's relatively muted reaction to the election result and the visit to Taipei by an "unofficial" US delegation should limit any spillover effect to the recent modest improvement in US-China relations.
- Taiwanese politics is unlikely to be the main driver of tensions and conflict risk over the coming 12 to 18 months. The US election potentially threatens to introduce significant policy uncertainty and inconsistency, potentially leading to a de facto end of "strategic ambiguity", which has been a key pillar of deterrence for the past 50 years.
- Indeed, in part reflecting the increased chances of a Trump presidency, we decreased the probability of the status quo persisting (40%, -5ppts) and increased the prospect of Taiwan risks becoming front-and-centre within China-US tensions (35%, +5ppts). We continue to judge that the risk of conflict remains low (10%) even if rhetoric often veers into the incendiary.

### Loss of legislature is a setback for Lai's presidency, but helps to reduce cross-strait tensions

Pro-independence Democratic Progressive Party (DPP) candidate (William) Lai Ching-te won Taiwan's presidential election with 40% of the votes, beating Kuomintang (KMT) candidate Hou Yu-ih and the Taiwan People's Party (TPP) candidate Ko Wen-je, who received 33.5% and 26.5% of the votes respectively.

The victory results in a historic third consecutive presidential term for the DPP, following Tsai Ing-wen's two terms. For the more Beijing-friendly KMT, the result will prompt them to reflect on their campaign style and approach to relations with Beijing.

However, parliamentary elections proved more fruitful for the KMT, which became the largest party in the Legislative Yuan. The DPP failed to gain a majority (57 out of 113), securing 51 seats, down from 61 in 2020. Meanwhile, the TPP secured eight seats and the final two seats were won by independent candidates, which will likely align with the KMT.

This leaves the TPP as kingmaker in the Legislative Yuan, with the KMT signalling its intention to work closely with the TPP. Whether this occurs will become clear by 1 February, when the legislature must elect a speaker and vice speaker. The two parties failed to agree on a coalition ahead of the elections.

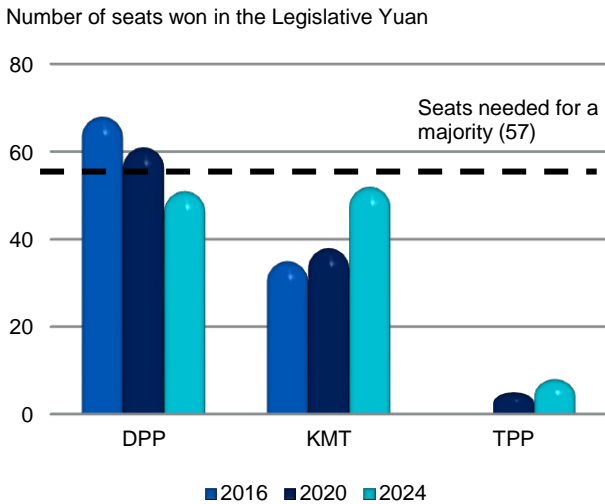
The loss of a majority in the legislature will weaken Lai's position as president, and concessions will be needed to get the legislative's backing on reforms and budgets.



This could result in the KMT and TPP pushing back slightly on the DPP's military strategic and pledges, such as to extend military conscription to 12 months.

The legislature will likely also scrutinise weapons purchases from the US, although both the KMT and TPP support an expansion in military spending.

**Figure 1: DPP loses majority in the legislature**



Source: Central Election Commission, abrdn, January 2024

**Beijing response has been muted as Lai seeks to de-escalate**

Cross-strait tensions remain elevated given Beijing's clear aversion to Lai's victory.

Lai, who had been vice president, is from the DPP's more independence-leaning faction. And his choice of former representative to the US, Hsiao Bi-khim, as his running mate, was perceived by Beijing as evidence that Lai's presidency could begin an intensified push for independence.

However, the parliamentary result has allowed Beijing to use democracy in its favour, declaring the outcome is evidence that the DPP "cannot represent the mainstream public opinion on the island".

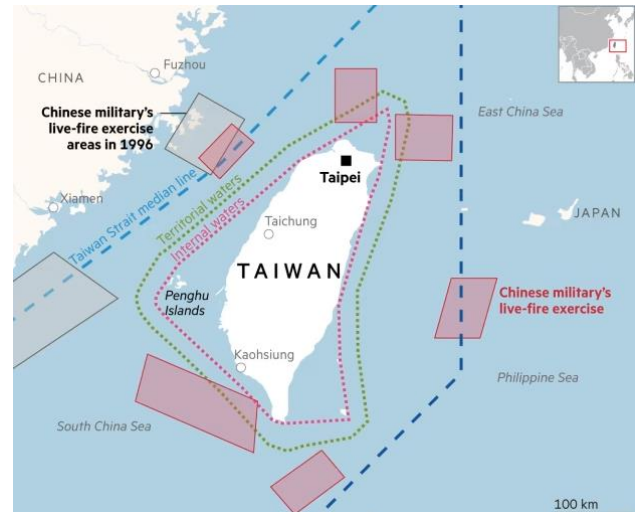
Following the results, Beijing's initial response has been fairly muted, with official communications reiterating the "one China" principle and opposition to any steps towards Taiwanese independence, with unification "inevitable". China's foreign ministry and embassies also criticised governments that congratulated Lai on his victory.

The DPP and US politicians made efforts to communicate their intention to maintain the status quo in attempt to reduce tensions. In his victory speech Lai took a conciliatory tone, calling for a resumption of communication between Taipei and Beijing, as well as avoiding mention of his predecessor's "four commitments", which promote Taiwan's sovereignty.

US President Joe Biden was quick to reaffirm the US did not support Taiwanese independence (and is firmly in favour of the status quo). Moreover, the fact that the bipartisan "unofficial" delegation sent to Taipei was made up of two former US officials – former national security adviser Stephen Hadley and former deputy secretary of state James Steinberg – rather than current officials, may have been an attempt to minimise the delegation's provocation to Beijing.

China reacted with a show of force to Speaker Nancy Pelosi's visit in August 2022 (see Figure 2), and while it is still possible that the US delegation invokes a reaction, China may be wary of a further deterioration of relations, following a relative improvement since Xi and Biden met on the sidelines of the APEC meeting and US-China militaries resumed dialogue.

**Figure 2: The PLA conducted its largest air and maritime exercises around Taiwan following Pelosi's visit in August 2022**



Source: Financial Times, August 2022

Nevertheless, it remains plausible that Beijing will respond to Lai's victory with a show of military strength, increased 'grey zone' actions, or via economic sanctions at some stage in the coming months. This may in part be for domestic audiences, but also to put pressure on Lai ahead of his inauguration in May and influence the KMT and TPP in the legislature.

One indicator will be how Beijing approaches its review of Taiwan's preferential tariff agreements under the China-Taiwan Economic Cooperation Framework Agreement (ECFA). Beijing removed tariffs and blocked imports of certain Taiwanese food exports in the lead-up to the election, so further punitive steps could be announced.

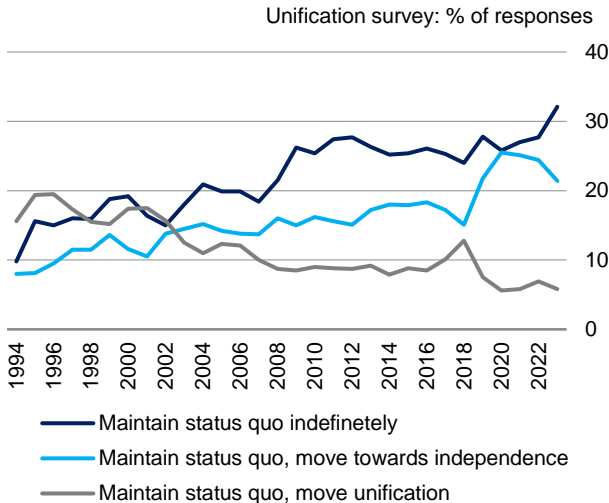
**Taiwan is unlikely to be the largest driver of risk...**

Taiwan's political drift away from mainland China remains a source of conflict risk. But it is unlikely to be a decisive factor over a 18-24-month horizon.



Beijing has made clear that moves towards independence will not be tolerated and ultimately both the DPP and KMT want to maintain the status quo, polling shows (Figure 3).

**Figure 3: Polling in Taiwan suggests maintaining status quo dominates, but preference for eventual independence is rising and for unification it is falling**



Source: Election Study Center, National Chengchi University, abrdrn (January 2024)

President-elect Lai is cognisant of the risks of testing China's tolerance, and while Taiwanese identity politics is likely to strengthen over time, there is little sign of a sudden move towards independence in the near-term. This puts more onus on monitoring US-China tensions.

**... US-China tensions are key for assessing conflict risk**

We continue to judge that there are powerful counterweights to the potential escalating factors between the US and China that could lead to conflict or invasion. Key reasons include:

- i. The West's response: the potential economic costs to China now appear larger following the actions taken by the West after Russia's invasion of Ukraine. China is much more integrated into Western supply chains and a withdrawal of Western investment, loss of trade or freezing of reserves access could be severely damaging for China's economy.
- ii. China's long-run hard and soft power is directly related to the size of its economy: we do not think the Chinese Communist Party (CCP) would be willing to risk severe sanctions and collateral damage, particularly given that China's economy could surpass the US within a decade or so.
- iii. A quick win is not guaranteed: Taiwan has become a national security issue for the US, with TSMC largely dominating production of advanced semiconductors used in state of the art weapons systems – this raises the chance that the US does in fact step in militarily. Even if the US does not

intervene militarily (which could be disaster for all), there is a risk that an invasion by China fails given the logistical difficulties posed by the Taiwan Strait. And even if "successful" the potential for protracted resistance could draw China into a prolonged insurgency, which damages the CCP's international standing via mass internments.

The US election arguably poses the greatest risk. Moving away from "strategic ambiguity" nullifies the "One China" policy which has been a bedrock of the US-China relationship. In the extreme, US policy confirming it would defend Taiwan could trigger a "closing window of opportunity" moment, whereby the calculus swings for Beijing, prompting an acceleration of unification plans. Similarly, there is a risk that US ramping up arms sales to Taiwan backfires.

Given these risks, we expect that "strategic ambiguity" will continue, at least in a *de facto* sense, but in practical terms policy continuity is far from certain, particularly under any future Trump administration. As such, we have reduced the probability of 'Status quo persists' and raised the probability of 'Taiwan tensions become front & centre' by 5 percentage points within our scenario table (see Figure 4).

Trump's first term in office saw official US policy towards Taiwan remain broadly unchanged. Trump's comments, however, were marked by inconsistency, alternating between advocating for traditional US support for strategic ambiguity and implying that policy towards Taiwan could be altered by trade concessions by China.

Trump's comments on his future foreign policy strategy on the campaign trail, while not explicitly outlining an approach to Taiwan, emphasise his desire to pull back from overseas conflicts. His comments imply that he would be focused on a transactional style of foreign policy that would likely lead to less enthusiastic endorsement of strategic ambiguity. If continued in office, this approach could undermine any deterrence effect the US attempts to pursue in the region, even if official policy remains unchanged.

A second Biden administration is also not entirely without risks. On a number of occasions President Biden has implied that the US would in fact launch a military response should China invade Taiwan, in direct contradiction of the strategic ambiguity policy. In each instance his administration has clarified that US policy remains unchanged – and this could be an attempt to address concerns that strategic ambiguity is suffering from diminished credibility – but any future comments risk muddying the waters and raising US-China tensions.



Figure 4: Taiwan scenarios

Scenario	Probability	Description	Waymarks	Constraints
Taiwan tensions ease	5%	China clearly communicates that Taiwan reunification is a long-run aim only and should not distract from near-term development goals. This source of US-China tensions abates even if others still remain.	'Grey zone' actions (South China Seas, airspace, cyber) reduce in frequency. CCP tones down 'wolf warrior' diplomacy. US reaffirms One China and strategic ambiguity policies. Taiwan cools pro-independence message. Advanced semiconductor production expands in China, reducing Taiwan's importance for national security.	Domestic politics in China limit scope for CCP to clarify Taiwan aims. Younger Taiwanese voters favour pro-independence political message. Most advanced semiconductor production likely to remain in Taiwan. US-China relations expected to deteriorate further.
Status quo persists (risks rise modestly over time)	40%	Current situation largely continues, with bouts of heightened tensions met by countervailing forces sufficient to deter escalation. US policy towards Taiwan remains unchanged and this is broadly communicated consistently. Risks rise somewhat over time, reflecting US-China tensions, Taiwanese political drift and growing Chinese power.	China continues with 'grey zone' actions but does not materially intensify frequency or scale. US administration commitment to strategic ambiguity as key deterrent unclear, but de facto retains policy as the key deterrent. This is not seriously undermined by the Presidency or Congress.	Missteps and overreactions by the US and China could threaten current balance. Shifting political landscape within Taiwan raises the risk that China loses patience. Increased militarisation of Taiwan risks "closing window of opportunity" moment.
Taiwan tensions become front & centre, but conflict is avoided	35%	Taiwan becomes a focal point as US-China relations deteriorate. Credibility of US policy becomes much less consistent; the credibility of its strategic ambiguity policy is repeatedly called into question as policy incoherence becomes embedded. Missteps and 'talking tough' heighten tensions and perceptions of conflict risk rise significantly, but conflict is ultimately avoided.	Technological rivalry between the US and China and trade tensions intensify. China's 'grey zone' actions broaden and intensify in an attempt to pressure Taiwan into reunification. US strategic ambiguity is severely undermined by political leaders. Taiwanese politics and rhetoric drifts further away from mainland China.	Rising US-China tensions raise the risk of conflict, but both sides have strong motivations to avoid conflict. If tensions do not spiral quickly the US may have time to expand its military presence, raising the stakes.
Conflict over Taiwan	10%	US policy towards China becomes more hostile, with significantly less focus on maintaining stable relations. China invades Taiwan. Uncertainty about US military intervention makes outcome uncertain, but major risk of a hot conflict followed by Cold War. At a minimum, Western alliance forms against China in terms of sanctions as internment of the Taiwanese population draws international condemnation.	US officially moves away from strategic ambiguity. Western nations impose tough sanctions, start to cut off Chinese access to dollar-based global financial markets and Western technology. Western governments put pressure on businesses to withdraw from China.	Chinese reunification aims would entail a huge risk to their development goals (even if conflict is avoided), threatening the CCP's legitimacy and Xi's legacy. Cutting off China would impose large economic costs on the West, but invasion is a severe challenge to Western-China economic relations.

Source: Haver, abrdrn, January 2024. Note: scenarios refer to an 18-24 month horizon, while probabilities do not sum to 100%.

**Authors**

Bob Gilhooly, Michael Langham & Lizzy Galbraith





## Important Information

### **For professional and Institutional Investors only – not to be further circulated. In Switzerland for qualified investors only.**

Any data contained herein which is attributed to a third party (“Third Party Data”) is the property of (a) third party supplier(s) (the “Owner”) and is licensed for use by abrdn\*\*. Third Party Data may not be copied or distributed. Third Party Data is provided “as is” and is not warranted to be accurate, complete or timely. To the extent permitted by applicable law, none of the Owner, abrdn\*\* or any other third party (including any third party involved in providing and/or compiling Third Party Data) shall have any liability for Third Party Data or for any use made of Third Party Data. Neither the Owner nor any other third party sponsors, endorses or promotes any fund or product to which Third Party Data relates. \*\*abrdn means the relevant member of abrdn group, being abrdn plc together with its subsidiaries, subsidiary undertakings and associated companies (whether direct or indirect) from time to time.

The information contained herein is intended to be of general interest only and does not constitute legal or tax advice. abrdn does not warrant the accuracy, adequacy or completeness of the information and materials contained in this document and expressly disclaims liability for errors or omissions in such information and materials. abrdn reserves the right to make changes and corrections to its opinions expressed in this document at any time, without notice.

Some of the information in this document may contain projections or other forward-looking statements regarding future events or future financial performance of countries, markets or companies. These statements are only predictions and actual events or results may differ materially. The reader must make his/her own assessment of the relevance, accuracy and adequacy of the information contained in this document, and make such independent investigations as he/she may consider necessary or appropriate for the purpose of such assessment.

Any opinion or estimate contained in this document is made on a general basis and is not to be relied on by the reader as advice. Neither abrdn nor any of its agents have given any consideration to nor have they made any investigation of the investment objectives, financial situation or particular need of the reader, any specific person or group of persons. Accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the reader, any person or group of persons acting on any information, opinion or estimate contained in this document.

### **This communication constitutes marketing, and is available in the following countries/regions and issued by the respective abrdn group members detailed below. abrdn group comprises abrdn plc and its subsidiaries:**

(entities as at 04 December 2023)

#### **United Kingdom (UK)**

abrdn Investment Management Limited registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL. Authorised and regulated in the UK by the Financial Conduct Authority.

#### **Europe<sup>1</sup>, Middle East and Africa**

<sup>1</sup> In EU/EEA for Professional Investors, in Switzerland for Qualified Investors - not authorised for distribution to retail investors in these regions

**Belgium, Cyprus, Denmark, Finland, France, Greece, Iceland, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, and Sweden:** Produced by abrdn Investment Management Limited which is registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL and authorised and regulated by the Financial Conduct Authority in the UK. Unless otherwise indicated, this content refers only to the market views, analysis and investment capabilities of the foregoing entity as at the date of publication. Issued by abrdn Investments Ireland Limited. Registered in Republic of Ireland (Company No.621721) at 2-4 Merrion Row, Dublin D02 WP23. Regulated by the Central Bank of Ireland. **Austria, Germany:** abrdn Investment Management Limited registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL. Authorised and regulated by the Financial Conduct Authority in the UK. **Switzerland:** abrdn Investments Switzerland AG. Registered in Switzerland (CHE-114.943.983) at Schweizergasse 14, 8001 Zürich. **Abu Dhabi Global Market (“ADGM”):** abrdn Investments Middle East Limited, 6th floor, Al Khatem Tower, Abu Dhabi Global Market Square, Al Maryah Island, P.O. Box 764605, Abu Dhabi, United Arab Emirates. Regulated by the ADGM Financial Services Regulatory Authority. For Professional Clients and Market Counterparties only. **South Africa:** abrdn Investments Limited (“abrdnIL”). Registered in Scotland (SC108419) at 10 Queen’s Terrace, Aberdeen AB10 1XL. abrdnIL is not a registered Financial Service Provider and is exempt from the Financial Advisory And Intermediary Services Act, 2002. abrdnIL operates in South Africa under an exemption granted by the Financial Sector Conduct Authority (FSCA FAIS Notice 3 of 2022) and can render financial services to the classes of clients specified therein.

AA-290124-173434-37

