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China, Taiwan, and the World Economic Order

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As the Russian invasion of Ukraine grinds into its fifth month, news coverage of the smoldering conflict seems to have reached a point of acceptance, if not outright nonchalance, that progress has plateaued for both sides and that this has become a drawn-out war of attrition in which we may be closer to the beginning than the end. Similarly, market participants have largely turned their attention to more salient issues like broad-based inflationary pressures and the implications with respect to the path of Federal Reserve policy going forward. To be fair, the cognoscenti have dissected and modelled the possible economic fallout from the Ukraine conflict for some time and, in the absence of further newsworthy developments, there is only so much pricing-in for markets to do. However, I would caution against the notion that the cohesion displayed by the West in their response to Russian aggression means that the post-World War II world order is strong enough to buffer us from all geopolitical unrest.

Russia is the world's 11th largest economy by nominal gross domestic product (GDP) and its most important contribution to the world economy is energy. Ukraine's GDP is the world's 55th largest. Yet conflict between these two eastern European nations have had far-reaching geopolitical and economic consequences. Early in the war, Switzerland abandoned its policy of neutrality when it recognized European sanctions against Russian actors, and Germany ended its embargo on weapons exports to conflict areas established following World War II. More recently, global political relationships have continued to shift including preliminary expansions to the NATO alliance (Sweden and Finland) and to the European Union (Ukraine). On the economic side, the focus was initially on energy as the major risk factor to the global economy. As the Ukrainian economy continues to be battered, there now exists major concerns a worldwide food crisis may be precipitated by the war in developing nations in coming months that will likely resonate for years. Ukraine's exports of oilseeds and grains have largely

stopped, and the price of wheat continues to increase as heatwaves reduce supply beyond Ukraine. China, the world's largest wheat producer, has signaled that rain-delayed planting last year will likely result in its worst-ever wheat crop. As tens of millions more globally are threatened with falling into poverty due to inflation in

costs for food and shelter, it is expected that political unrest will spread.

I have long maintained that, among the foreseeable challenges facing the world economy and political order, few loom larger than that of China's plans to become the world's leading global power. In 2017, President Xi Jinping opened the National Congress with a plan to make China the world's leading superpower. In May 2022, U.S. Secretary State Blinken stated "China is the only country with both the intent to reshape the international order and increasingly the economic, diplomatic, military, and technological power to do it." He noted China as "one of the most complex and consequential relationships of any that we have in the world today," while also stating that "[w]e are not looking for conflict or a new Cold War." Blinken accused China of provocative behavior, citing efforts to cut off Taiwan's relations with other countries and flying military aircraft in Taiwanese territory. "These words and actions are deeply destabilizing. They risk miscalculation and threaten the peace and stability of the Taiwan Strait," Blinken said. While the U.S. has maintained an approach to Taiwan that opposes any unilateral changes to the status quo from either China or Taiwan – an approach that has been consistent across decades and presidents from both political parties – President Joe Biden has said that the United States would intervene militarily if China attempted to take Taiwan by force.

I wrote in my April article that China was likely assessing the Ukraine conflict with a keen eye toward whether Russia could effectively fortify its economy against Western sanctions. It is possible that the magnitude and breadth of the sanctions levied against Russia, and the solidarity displayed by the West in implementing them, surprised Chinese observers. While this may have given China some pause in considering an invasion of Taiwan, my belief is that at best it delayed the timeline rather than scuttling China's ambition entirely. On the contrary, there are reasons to think Xi Jinping may become increasingly anxious to proceed with reunifying Taiwan. Most pressing for China's leaders is that the demographic situation will not improve any time soon. As the population ages, the vibrant consumer sector long sought by China's central planners becomes increasingly unlikely to develop. An increasing number of retired citizens supported by a decreasing number of able-bodied workers may mean the Chinese economy never returns to sustained double digit growth rates. A loss of economic clout in the region may leave an opening for the United States to establish economic alliances in China's sphere of influence that would magnify any sanctions levied against China for invading Taiwan the longer it waits. Therefore, even if the United States does not actively move to establish a "NATO of the East", Chinese leadership may feel compelled to move on Taiwan before their own domestic window of opportunity closes any further.

The United States and China are the two largest economies in the world. A conflict in the region would likely also involve Japan, the world's 3rd largest economy. The geopolitical and economic consequences of a Chinese invasion of Taiwan would far surpass those currently emanating from the Ukraine conflict. China is far more entrenched in the global economy than Russia. A war in the Western Pacific would disrupt critical shipping lanes, and stress on US-Chinese relations would likely further deepen the supply chain issues already brought forth during the COVID pandemic. I do not believe China, under its current leadership, will abandon its ambition to reclaim Taiwan. How much longer Xi Jinping feels comfortable waiting is the more relevant question for the world economic order.

Alan Greenspan served five terms as chairman of the Board of Governors of the Federal Reserve System from August 11, 1987, when he was first appointed by President Ronald Reagan. His last term ended on January 31, 2006. He was appointed chairman by four different presidents.

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