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PAMIR Executive Brief

Taiwan Update

17 May 2023

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The US Army Special Operations Command (USASOC) for the first time used a scenario simulating defense of Taiwan against a Chinese invasion in its annual capabilities exercise (CAPEX) in April. According to US military public information, the exercise involved landings behind enemy lines, seizures of air landing strip, tunnel destruction, capture evasions, Switchblade kamikaze drone operations, and information warfare.

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Executive Summary

- China criticized US defense industry overtures to improve Taiwan's defense industrial capabilities and US Army exercises simulating defense of Taiwan, equating them to what Beijing sees as a US proxy war in Ukraine.
- Taiwan exports dropped broadly in the first four months of 2023, and GDP contracted over the last two quarters, leading some economists to assess that Taiwan already has entered a recession.
- China continues to use restrictions on imports of Taiwan agricultural products to pressure the ruling DPP party's power base into dropping support for any form of Taiwan independence.

> *...Taiwan asked the US for help in developing Taiwan's own next generation fighters in engines, avionics, and environmental controls. The most likely areas of initial cooperation could be in military unmanned aerial vehicles and ammunition. Concrete results could be delivered as early as 2025.*

Defense

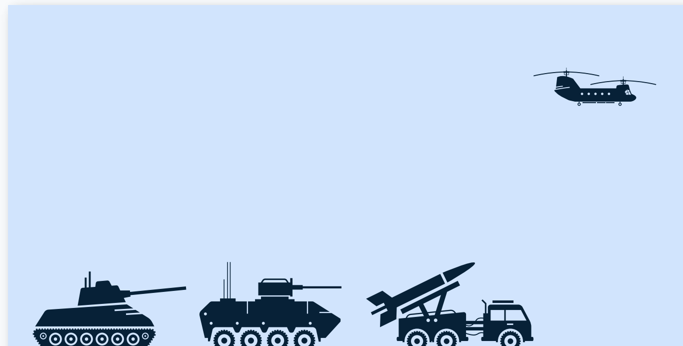
The US Army Special Operations Command (USASOC) for the first time used a scenario simulating defense of Taiwan against a Chinese invasion in its annual capabilities exercise (CAPEX) in April. According to US military public information, the exercise involved landings behind enemy lines, seizures of air landing strip, tunnel destruction, capture evasions, Switchblade kamikaze drone operations, and information warfare.

- Lt. Gen. Jonathan Braga stated at the exercise outset, "The PRC, in accordance with our national defense strategy, is our pacing challenge out there." A statement from USASOC emphasized, "Ultimately, what we are trying to do is prevent World War III. That's our job."
- A Chinese military expert commented that this exercise indicates the US wants to duplicate what it is doing in Ukraine. Chinese and Taiwan media reported that US special operations forces are already in Taiwan, assisting the Taiwan military's special operations training. The Pentagon and Taiwan Defense Ministry refused to comment on the reports.

> *China's Ministry of National Defense spokesman said China was "extremely concerned" about US-Taiwan defense industry collaboration and warned that Taipei's practice of "bringing wolves into your home is repugnant and will only bring a deep disaster" to Taiwan*

On 1 May a delegation of 25 US defense industry companies led by retired Lt. General Steven Rudder, former US Pacific Marine Commander, arrived in Taiwan. The delegation included representatives from major defense contractor companies, including Lockheed Martin (F-16s); Raytheon (radar and missiles); and AeroVironment (Switchblade kamikaze drones). During their four-day stay, the delegation attended the Taiwan-US Defense Industry Forum and visited some Taiwan defense research institutions and companies.

- According to Taiwan media, the US delegation and Taiwan's government and defense companies discussed possibilities of 1) improving Taiwan's own defense industrial capabilities; 2) producing select American weapons in Taiwan; and 3) inviting Taiwan into the US defense industry supply chain. During the forum, Taiwan asked the US for help in developing Taiwan's own next generation fighters in engines, avionics, and environmental controls. The most likely areas of initial cooperation could be in military unmanned aerial vehicles and ammunition. Concrete results could be delivered as early as 2025.
- China's Ministry of National Defense spokesman said China was "extremely concerned" about US-Taiwan defense industry collaboration and warned that Taipei's practice of "bringing wolves into your home is repugnant and will only bring a deep disaster" to Taiwan. China's Foreign Ministry said the visit was "further proof that the US is turning Taiwan into a powder keg, which only spells trouble [for Taiwan.] We once again urge the US to abide by the One China principle and the three China-US Joint Communiqués, stop arms sales and military contact with Taiwan." During the US delegation visit, the Chinese military increased its incursions into Taiwan's air defense identification zone.



TAIWAN HAS SPENT $22 BILLION FOR US ARMS PURCHASES OVER THE LAST SIX YEARS SINCE THE RULING DPP CAME INTO POWER.

THIS YEAR TAIWAN RAISED ITS DEFENSE SPENDING TO 2.4% OF GDP.

Economy

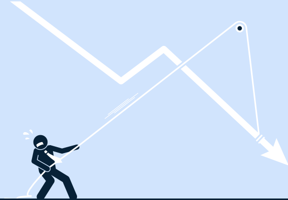
On 9 May the Taiwan government released its foreign trade data for the first four months of 2023. Exports dropped 17.7% YoY, the largest in 14 years since the global financial crisis in 2008 — this continued the decline over the last eight months. Taiwan exports to major trading partners like China (including Hong Kong) dropped 28.5%; US, -15%; ASEAN, -14.1%. Only exports to Japan increased, 1.2%.

Cross-Strait trade tensions are increasing. China has banned at least 97 Taiwan products, while Taiwan banned imports of 2,460 mainland products. Eleven major Taiwan exports to China had a significant drop over the last four months: plastic and rubber products dropped 40%; textiles -28%.

In the first quarter of 2023, Taiwan's trade surplus with the mainland dropped 35%. In April, China announced investigations into imports of 2,455 Taiwan products that now enjoy almost tariff-free status.

- The investigation carries a strong political message, is planned for nine months, and can be extended to 12 January 2024, the day before Taiwan's presidential election.
- After the DPP came to power in 2016, China has particularly targeted agricultural products to influence Taiwan farmers, who are a major power base for the DPP. In 2018, 23% of Taiwan agricultural products went to China; in 2022, only 12% were exported to China. Similarly, 85% of Taiwan fruit exports went to China five years ago; but by 2022 had dropped to less than 2%.

TAIWANESE EXPORTS DROPPED BY 17.7% THE LARGEST FALL SINCE THE 2008 FINANCIAL CRISIS



TAIWAN EXPORTS TO THE US DECLINED

JANUARY	FEBRUARY	MARCH	APRIL
14.4%	13.7%	20.7%	10.3%

Taiwan economists observe that Taiwan has not benefitted from US trade disputes with China, and instead many US import demands shifted from China to the EU, Mexico, Canada, and ASEAN. Taiwan exports to the US declined 14.4% in January, -13.7% in February, -20.7% in March, and -10.3% in April.

A key reason for Taiwan's export challenge is its exclusion from regional trade blocks like the Regional Comprehensive Economic Partnership (RCEP), a free-trade arrangement among 15 Asia-Pacific countries that started in January 2022. In the RCEP, 92% of traded goods are tariff-free.

- Taiwan economists give the example of South Korea, which also suffered from export decline and a significant drop in trade surplus in 2022, but its trade with RCEP countries increased greatly, making South Korea the world's sixth largest exporter in the world.
- Taiwan's ranking, on the other hand, dropped from #16 to #17 last year. Taiwan's economic minister explained that Taipei has not applied to the RCEP because RCEP overlaps with the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership), and Taiwan is actively working to join CPTPP.

Geopolitics also adds uncertainty to Taiwan's exports. Nikkei Asia reported on 27 April that multinational corporations are inserting into their commercial contracts clauses related to a possible crisis across the Taiwan Strait. Such crises could cause logistic disruptions, sanctions and asset freezes. Furthermore, geopolitical risks could discourage export-oriented foreign investment in Taiwan.

Exports support more than 70% of Taiwan's GDP. Unless Taiwan's export situation improves, Taiwan's economy will have some serious problems.

Although Taiwan's GDP in 2022 grew 2.45%, Taiwan economists point out that GDP has had negative growth in Q4 2022 (-0.86%) and Q1 2023 (-3.02%), the lowest in 14 years. Some economists observe the Taiwan economy has already entered a recession.

Politics

According to the latest Taiwan media poll published in early May, the top three contenders in the 2024 presidential election campaign are:

- **HOU You-Yi**, incumbent mayor of New Taipei City, leading with 32.5% support. He is from the largest opposition party, the KMT, which on 17 May selected Hou as its candidate.
- **LAI Ching-te**, the ruling DPP's only candidate for the 2024 election. He currently is vice president and polled at 27.7%.
- **KO Wen-je**, chairman of the Taiwan People's Party (TPP) and former mayor of Taipei City, 19.5%. TPP is Taiwan's third largest political party.

The ruling DPP's key message on China for the 2024 election echoes its 2020 messaging: rejecting the One China concept and maintaining Taiwan's independent identity. The DPP continues to solicit US support to resist mainland coercion and invasion.

"One China but two governments"

The KMT and TPP favor "One China but two governments" and call for reconciling relations with Beijing to maintain peace across the Taiwan Strait. Since the KMT and TPP have similar policy platforms, both parties may split the vote and give DPP another win. The Taiwanese Public Opinion Foundation poll found the DPP had 34% public support, KMT 21.5%, and TPP 20.3%.

Strategic Outcomes

Beijing sows uncertainty

LEVEL OF CONCERN

5 4 3 **2** 1

Pamir assesses that foreign firms' drafting contracts to mitigate against risks of a Taiwan crisis illustrates Beijing's effectiveness in sowing uncertainty over Taiwan's security and stability, if the DPP retains ruling power in 2024.

Pamir Position

Pamir foresees that if Taiwan's 2024 presidential election outcomes favor cross-Strait "reconciliation", Taiwan's economic situation would benefit, but US firms may find competitors from other countries receiving greater attention from Taipei as a concession to Beijing.

Business Impact

Pamir observes that geopolitical risks related to Taiwan Strait tensions should be factored into foreign companies' contingency planning against logistic and supply disruptions, sanctions, asset freezes, and detention of personnel. US companies in advanced technology and defense industries can expect greater scrutiny of operations in greater China.

Strategic outcomes

Level of Concern indicators - what they mean

1 - indicates no change to the status quo

2 - indicates escalating tensions

3 - indicates aggressive escalation

4 - indicates high probability of impending crisis event

5 - indicates a full-scale crisis or conflict situation.

How we calculate them

- Frequency of references to subject in Chinese-language official government statements, credible press reporting, and social media
- Frequency of references to subject in English-language official government statements, credible press reporting, and social media from the US, EU, UK, Australia, Japan, etc.
- Consistency of historical, current, and emerging trendlines related to the subject
- Aberrations in official Chinese-language policy formulations
- Strategic shifts in official Chinese government and military signaling through diplomatic, information, military, and economic actions and behavior

Analytic Methodology: internal monitoring with quantitative and qualitative analysis of Chinese media and propaganda; comparative trend analysis, intelligence tradecraft; other proprietary methods.

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