

Taiwan needs to reinvent itself

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Signs of change in Taiwan. Tsai Ing-wen, the candidate for the opposition Democratic Progressive Party (DPP), achieved a resounding victory in the presidential elections on 16th January 2016. The DPP has also replaced the Kuomintang party (KMT) as the strongest power in the Legislative Yuan, the Taiwan parliament. The DPP has high expectations of being able to get Taiwan's economy back on track following its sharp economic slowdown. However, rapid results are not expected despite the change in leadership and the clear parliamentary majority. The crucial factor here is what will happen in terms of the political and economic relations with China.

Stagnant economy in 2015


2015 was a difficult year for Taiwan's economy. After the gross domestic product (GDP) increased in the first three months by around four per cent in real terms, growth then fell dramatically. In the third and fourth quarters, the country even reported negative growth rates of 0.8 and 0.5 per cent. Taiwan is therefore technically in a recession.

According to estimates by the Directorate General of Budget, Accounting and Statistics (DGBAS), the economic output in-

creased by 0.75 per cent (adjusted for prices) over 2015 as a whole. The GDP therefore only rose by an average of 2.8 per cent p.a. during the period of office of the KMT President Ma Ying-jeou between 2008 and 2015, bearing in mind Taiwan was experiencing near-consistent growth rates of five to six per cent in the preceding years (DGBAS, "GDP: Preliminary Estimation for 2015 Q4 AND Outlook for 2016 ", Press Release, 17th February 2016, Engl., Chin.). Ma also planned growth at around this level for his time in government.

This slowdown can primarily be explained by the fact that after joining the World Trade Organisation (WTO) on 1st January 2002, Taiwan relied increasingly on exports to drive growth at the expense of private consumption and investments in equipment and, as a result, became highly dependent on the highs and lows of the global economy (US-China Economic and Security Review Commission, Taiwan's Economy amid Political Transition, 6th January 2016, p. 9). Whereas in 2001, the export rate barely reached 49 per cent, in the years that followed this figure climbed temporarily to almost 73 per cent (Statistical Bureau, National Statistics Republic of China (Taiwan): National Accounts, <http://eng.stat.gov.tw>). As a result, Taiwan benefited a great deal from the dynamics in world trade, particularly before the start of the international financial crisis in 2008 and from the subsequent recovery, after which the economy in important target export countries gradually slowed down. This was reflected both in the falling export rate (2014: 64.5 per cent) and in the considerably lower growth rates in the domestic economy. During 2015, this downward trend was exacerbated even further in light of the major global economic problems.

Taiwan is severely affected by the economic slowdown in China, which has been its most



important trade partner since 2005. Since then, economic relations have become increasingly closer. In 2014, the bilateral exchange of goods, including Hong Kong, stood at 174.3 billion U.S. dollars, or just below 30 per cent of Taiwan's total foreign trade (Bureau of Foreign Trade, Trade Statistics, <http://cus93.trade.gov.tw/english/fsce/>). In exports alone, China and Hong Kong's share made up around 40 per cent.

Even though, for a number of years, Taiwan made a great deal of profit in the wake of China's success as it rose to become the second largest global economic power and the "workbench of the world", the downside of this dependency has been clear since 2015. China's high annual growth rates of ten per cent and higher, and thereby the seemingly unlimited acceptance of all kinds of products, are now well and truly over. This is reflected in the trend in Taiwanese exports to China and Hong Kong. According to information from the Ministry of Finance in Taipei, in 2015, this figure dropped by 12.4 per cent compared to the previous year to 112.6 billion U.S. dollars. This was the largest decrease since 2009. Taiwanese global exports "only" fell by 10.8 per cent (Ministry of Finance, 105 nian haiguan jin chukou maoyi chubu tongji" (Preliminary statistics on customs import and export, January 2016), Press Release, 16th February 2016).

Uncertain outlook for 2016


Given the uncertainty of how China's economy will develop, it is not expected that 2016 will see a definite turnaround in Taiwan's export business. According to the Ministry of Economic Affairs (MOEA), export orders in 2015 were 4.4 per cent lower than in the previous year based on U.S. dollars in 2015. Orders received from China and Hong Kong fell by 8.9 per cent, with

those from Japan dropping by a massive 22.9 per cent. Only the USA (+6.3 per cent) offers a glimmer of hope (MOEA, 104 nian 12 yue waixiao dingdan tongji (Statistics on export orders, December 2015), Press Release, 20th January 2016).

In light of this, 2016 is once again not expected to be an easy year for Taiwan's economy as a whole. While in November 2015 the DGBAS was still quite hopeful that the GDP could increase by 2.3 per cent in the new year (DGBAS, Guomin suode tongji ji guonei jingji qingshi zhanwang (Outlook for national income statistics and the domestic economic situation), Press Release, 27th November 2015), the authorities are now forecasting real growth of just 1.47 per cent (DGBAS, "GDP: Preliminary Estimation", Ibid.). They are forecasting only a limited recovery with regard to exports. With regard to domestic demand, the DGBAS anticipates that most of the impetus will come from government investments.

The search for a new growth model

If this goes according to plan, the new President Tsai Ing-wen, who comes into office in May 2016, would be under considerable pressure from the outset as the dissatisfaction of many Taiwanese with Ma Ying-jeou's economic policy was the main reason why the DPP and its candidate were so successful in the elections. However, she will not have to work out a solution for the urgent issues alone. Like other countries in the region, Taiwan is also facing major structural difficulties. Most noticeably, the population is ageing extremely quickly: It is estimated that by 2025, a fifth of the population – around 4.7 million people based on current figures – will be over 65 years old, whereby the country would meet the criteria for a "superaged society" ("MOHW tackles Taiwan's ageing society challenges", Taiwan Today, 26th June 2015,



www.taiwantoday.tw). However, a development such as this will put extreme pressure on the social systems. In addition, questions also need to be asked on how Taiwan will deal with immigration in the future in order to compensate for the consequences of the ageing population (Tsai Hung-jheng, "Demographic Transition and Building Civic Nationalism in Taiwan", Taiwan Braintrust Newsletter, No. 41, December 2015, p. 6-7, www.braintrust.tw).

The country has now also reached the point where the current development model must be thoroughly reviewed. Up until now, Taiwan's competitiveness has been primarily based on manufacturing to order (e.g. semiconductors, tablets) or, as part of regional supply chains, supplying preliminary and intermediate products and generating growth via exports, especially to China. This has continually improved efficiency (in production).

However, this model is at risk: Innovations are mainly taking place outside Taiwan and the country's strong production engineering base is coming increasingly under threat. Efforts made by Chinese high-tech companies in particular to cover the entire value added chain for their products and thus to make themselves more independent from Taiwanese preliminary and intermediate products are putting pressure on the country (US-China Economic and Security Review Commission, Ibid., p. 7). This is being exacerbated by the fact that China is also in the process of changing its development model. More innovation for goods "Made in China" is a key requirement here (D. Rehn, "China's economy at a crossroads", EU-Asia Economic Governance Forum, Konrad-Adenauer-Stiftung, Tokyo international office, 8th December 2015).


China considers the semiconductor industry, in which Taiwan maintains a top position, to

be a sector of strategic importance and wants to expand it over the next few years using large sums of state aid (US-China Economic and Security Review Commission, Ibid., p. 23 onwards.). If this import substitution succeeds, Taiwan would be hit where it hurts most as more than half of its total exports are electronic components and parts destined for China and Hong Kong (Ministry of Finance, 105 nian haiguan jin chukou maoyi chubu tongji", Ibid.).

Taiwan wants "to become more innovative"

In light of all these problems, Taiwan therefore also needs to convert its development model into an innovation strategy, explained Tsai Ing-wen in a speech outside the Washington-based Center for Strategic and International Studies (CSIS) in June 2015 in which she presented her ideas regarding economic policy. She hopes that this will also enable Taiwan to reduce its dependency on just one market (= China) and to secure economic autonomy. She explained that if this succeeds in generating more growth, the country can also invest more in social infrastructure, e.g. in housing construction and in nursing care, and thus tackle its pressing social problems (Tsai Ing-wen, "Taiwan Faces the Future", Video, 3rd June 2015, speech manuscript in English: "Taiwan Meeting the Challenges: Crafting a Model of New Asian Value, 4th June 2015, <http://csis.org>).

This realisation that Taiwan needs more innovation is actually not a new one. Steps in this direction had already been taken under Ma Ying-jeou: In February 2014, the Ministry of Science, together with the semi-governmental Industrial Technology Research Institute (ITRI), unveiled a project to support small- and medium-sized companies in areas such as system design, prototype development and product tests (J.



Maurer, "Taiwan sucht neue Wege der Industrieentwicklung" [Taiwan looks for new ways to develop industry], Germany Trade and Invest, 14th March 2014).

It is assumed that Tsai Ing-wen will promote this and other approaches. As information and communication technology plays such a major role in Taiwan's economy, this sector is one of the most important areas of focus. In this context, the new president intends to place particular emphasis on cloud computing, big data and the new developments in Industry 4.0 and, in so doing, to expressly focus on close cooperation with the USA (Tsai Ing-wen, "Taiwan Faces the Future", Ibid.).

However, this change of course is not expected to be easy. For a number of decades, Taiwan has stood its ground as one of the most important locations in the world for industrial manufacturing and as an important player in the high-tech industry. But times are changing: In the future, the demand for ideas, software, a range of application-specific solutions, design and marketing in particular will increase significantly compared to current demand. However, given the still very conservative corporate culture in Taiwan, some people are questioning whether the country will be able to keep up sufficiently in this area (P. Mozur, "In Taiwan, Survivor Mentality Stymies Tech Innovation", International New York Times, www.nytimes.com/2016/01/16).

Despite the fact that the government has been funding start-ups for some years now (J. Maurer, "Taiwan sucht junge Unternehmensgründer" [Taiwan looks for young company founders], Germany Trade and Invest, 23rd December 2014) and the Ministry of Science and Technology set up an innovation centre in California's Silicon Valley in June 2015 using public funds, Tai-

wan's start-up scene is still relatively small. Instead, what is noticeable is the increase in the "brain drain" from the island. Young people in particular, from creative industries such as animation or from areas such as chip design, are looking for opportunities elsewhere since they cannot find appropriate work in their own country. It seems that China especially is poaching a large number of experts in these branches of industry from the island (A. Ramzy, "Taiwan's brain-drain prompts worries", International New York Times, 16th January 2016, p. 1).

Relations with China as a key factor

Tsai Ing-wen and her new government are being asked to keep talented people in the country or to encourage them to return by means of persuasive measures. However, the answer to many other questions concerning economic policy, primarily the planned conclusion of a new free trade agreement – despite the desire for increased diversification – mainly depends on how relations with China develop.

During his term of office, the outgoing President Ma Ying-jeou has promoted economic ties with China in an unprecedented manner. In 2010, the two countries signed a free trade agreement called the Cross-Strait Economic Cooperation Framework Agreement (ECFA). At least in the early years, this provided a great deal of impetus for the bilateral exchange of goods. However, other planned agreements, including one to liberalise the service sector – the Cross-Strait Service Trade Agreement (CSSTA) – as part of the ECFA, have been met with a great deal of resistance in Taiwan and have had to be shelved (US-China Economic and Security Review Commission, Ibid., p. 6).

The KMT saw the liberalisation of trade under the ECFA as a means of obtaining China's approval to sign further free trade agreements. The party is primarily interested in the "Regional Comprehensive Economic Partnership", a planned agreement between the ASEAN states and the countries with which the South-East Asian block already has a free trade agreement, including China. By contrast, Tsai Ing-wen in particular is calling for Taiwan to join the Trans-Pacific Partnership (TPP) as quickly as possible – something the USA and Japan have already agreed to (Tsai Ing-wen, "Taiwan Faces the Future", Ibid.). However, the new president is also not ruling out the possibility of her country joining the RCEP, as she explained in an electoral campaign television debate (B. Hioe, "The TPP, RCEP, and the question of free trade agreements for Taiwan under a Tsai presidency", Blog, <https://newbloommag.net/2016/01/13>).

Whether it joins the RCEP or the TPP, if the relations between Taipei and Beijing get worse after Tsai Ing-wen comes into office, Taiwan has little chance of making its free trade initiatives a success. In the short term, there is not expected to be a great deal of progress on this issue, especially as China has already announced its stance on the RCEP. Taiwan would have to approve the other ECFA agreements in order to even be considered a partner (US-China Economic and Security Review Commission, Ibid., p. 29) – a move not currently anticipated from Tsai Ing-wen. Instead, she wants to renegotiate the follow-up agreements for the ECFA, for example. She also intends to regulate other contacts and agreements in the new Cross-Strait Agreement Oversight Bill. China, on the other hand, is expected to strongly oppose this.

Against this background, both sides are likely to sound out the opposing positions and interests first. The hope is that this will

result in contacts. However, there are a large number of obstacles to overcome. Beijing sees the DPP as a party which is potentially working towards the independence of the island and, correspondingly, is making approval of the "1992 Consensus" a requirement for talks. According to this consensus, both sides recognise that they are part of "one China". However, Tsai Ing-wen does not accept this position. If Taipei and Beijing maintain their firm stance, however, it is difficult to imagine any progress being made with regard to the bilateral relations. The two parties are treading a very fine line.

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