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The Biden Administration and Taiwan's Economic Prospects

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With three per cent gross domestic product (GDP) growth in 2020, Taiwan's economy had outperformed that of most countries in the world. The moderate economic expansion was attributed to a surge in external demand for information and communications technology (ICT) goods and a return of investments from abroad. Domestic consumption remained resilient thanks to domestic tourism and the government's economic stimulus measures. A huge part of Taiwan's economic success could be attributed to its efficient handling of the COVID-19 and to the economic circumstances that the ongoing global pandemic crisis has generated.

Strong external demand from the United States and Europe remains key to Taiwan's economy. Taiwan's strong reliance on these two markets is shown on its orders for exports of final consumption goods. In 2020, the United States and Europe accounted for a respective 38% and 35% of Taiwan's total export orders for ICT goods, compared to only eight per cent for China and Hong Kong.

After putting the virus outbreak under control, the rebound in China's industrial production has revamped cross-strait production networks for final consumption goods destined mainly for the US and European markets. In 2020, 91% of Taiwan's export orders for ICT goods were produced overseas, chiefly in China. This partly explained Taiwan's growing exports of mostly electronics components to China in 2020 for assembling. Another reason was the US-China

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trade war. China's Huawei has increased its orders of chips from Taiwan Semiconductor Manufacturing Company (TSMC) before the US ban on chips supply to China took effect.

With the election of Biden, US-China relations are due for a reset. There are several implications for Taiwan's economy. First, unlike President Trump, President Biden does not support economic decoupling from China. The new administration also disagrees with containing China by restraining China's exports to the United States. As such, Taiwanese firms' investment repatriation, spurred by US restrictions on Chinese exports, may decelerate.

Nevertheless, Taiwanese firms may continue to relocate factories to other developing countries due to the geopolitical uncertainty and cost consideration. Relocating manufacturing production away from China does not mean weaker manufacturing ties across the strait. The signing of China-ASEAN free trade area and Regional Comprehensive Economic Partnership (RCEP) could facilitate the construction of a production network between China and ASEAN countries, and benefit Taiwanese firms with investments in these countries. The greater regional economic integration, coupled with Taiwan's New Southbound Policy, is likely to expand cross-strait production network that includes ASEAN.

Second, the Biden administration plans to continue with Trump's policy of shifting supply chains back to the United States. Apple's two largest production partners, Foxconn and TSMC, and other Taiwanese semiconductor firms have responded to the policy, leading to a marked increase in Taiwan's investment in the United States in 2020. The United States is now Taiwan's second largest investment destination, accounting for a quarter of total outward investment in 2020, after China's one third. However, Taiwan's investment in electronic parts and components manufacturing in the United States was double the size of its investment in China in 2020.

Taiwan's manufacturing investment in the United States is chiefly for meeting local demand. This suggests that Taiwan's exports to America are set to decline as these goods can now be produced locally. In contrast, Taiwan's imports from the United States are likely to rise. With Taiwan's relaxation of import restriction on US pork from January 2021, Taiwan's import of US agricultural goods is expected to increase, so will its import of natural gas. Since 2018, Taiwan has also increased its imports of crude oil from the United States. All these indicate a future shrinkage in Taiwan's trade surplus with the United States.

Third, unlike Trump's bilateral approach, the Biden administration vowed to contain China through working with US allies. The effectiveness of Biden's multilateral approach to counterbalance China's power rise however remains to be seen. Unlike a few decades ago, many US traditional allies today are economically reliant on China and do not want to have to make a choice between the two.

In addition, China has already taken the lead in developing a multilateral trade network over the past few years. It is a key member of the RCEP and has signed an in-principle agreement with Europe on investment, the EU-China Comprehensive Agreement on Investment (CAI). China has also expressed its interest to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). In comparison, the United States has yet to be involved in any regional free trade agreement (FTA). It will therefore take time for the new administration to rebuild a US-centred multilateral economic network.

For Taiwan, due to its exclusion from most regional economic agreements, it is increasingly dependent on ICT exports as it enjoys preferential tariff rates for ICT goods under the

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international technology agreement of the World Trade Organisation (WTO). There is a need for Taiwan to join the RCEP and CPTPP to diversify its exports in other goods and services. However, Taiwan is less likely to be part of RCEP due to China's political pressure on RCEP countries. The economic agreements with New Zealand in 2013 and Singapore in 2014 did not pave the way for Taiwan to join RCEP. It is also unrealistic for it to rely on the Biden administration to bring Taiwan into the CPTPP.

Although President Biden has indicated his support for Taiwan, the support will likely be low-key. This is evidenced by his low-key acceptance of President Tsai Ing-wen's congratulatory message through diplomats on both sides. This contrasts with President Trump's direct pick-up of President Tsai's phone calls after his election in 2016. Bringing Taiwan into CPTPP or other regional economic agreement is certainly not the "low-key" approach that President Biden is likely to take.

A possible scenario is that China joins the CPTPP first, followed by Taiwan at a much later date, a scenario that replicates Taiwan's and China's participation in the WTO two decades ago. However, this scenario will take a long time to materialise. It is still unclear whether Japan is agreeable to China's inclusion in the CPTPP. If included, it will also take time for China to meet the high standards set in the CPTPP due to China's less developed economy. Evidently, Taiwan's economic advancement and further modernisation cannot wait.

To overcome the political barriers, Taiwan has already started to establish bilateral economic agreements with some countries through a "building blocks" and "bottom-up approach". To move forward, Taiwan may consider forging economic agreements with countries that do not favour China and focus on sectors that both Taiwan and its partners have comparative advantages in. For example, Taiwan can consider signing agreements with India to facilitate the exports of Taiwan manufactured goods and imports of India's services. Bilateral agreements with select partners could also allow Taiwanese business to explore overseas markets for enhancing its low value-added service industry. It would be good for Taiwan to take advantage of the potential economic agreements to better prepare itself for joining any high standard FTA in the future.

China's economic strength and extensive economic linkages suggest that a US unilateral harsh policy towards the country would disrupt the world economy. Biden's relatively "soft approach" towards China may ease the tension between the two powers politically and economically. Slowing down Taiwan-US rapprochement of the Trump administration may also be considered by the Biden administration which has placed emphasis on a multilateral approach. Reduced tensions in US-China relations may renew cross-strait economic integration. It may, however, lead to a potential leakage of US technology to China, through Taiwan.

Given the development of 5G, ICT goods and electric cars in prospect, Taiwan's manufacturing-oriented economy is likely to maintain decent growth in the short term. In the long run, the geopolitical uncertainty and the US-China competition in high technology remain the most important variables in Taiwan's economic outlook.

Taiwan will have to continue to maintain its manufacturing strength, encourage innovation, and attract talents and investors. It will also have to strengthen its financial services to better meet the financial demand of the highly developed manufacturing industry and to create the much-needed synergy between the semiconductor industry and other industries in order to address the imbalance in Taiwan's economic development. The Taiwanese government will also do well to ensure a fair business environment for all domestic and foreign business to

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compete in. A strong and competitive economy will be the best defence for Taiwan's national interests in the future.

Note: A version of this commentary also appeared in Taiwan Insight on 17 February 2021, <https://taiwaninsight.org/2021/02/17/the-biden-administration-and-taiwans-post-covid-economic-prospect/>.

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