

# The U.S.-China Trade Confrontation and Taiwan's New Southbound Policy: An Economic Security Perspective

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## **Abstract**

This paper starts by working back to the origins of cross-Strait economic relations and highlights the great debate in Taiwan society about the need to normalize cross-Strait trade and investment. It also pinpoints the structural changes to China's investment environment that have led to a gradual retreat of Taiwanese businesses from its market. The outbreak of the U.S.-China trade friction last year only accelerates such a trend. In order to react to the structural evolution of cross-Strait economic relations, the Tsai Ing-wen administration not only sees it as a challenge to Taiwan's economic security but also has adopted measures to deal with it. The "New Southbound Policy" introduced by the Tsai administration more than two years ago was a manifestation of Taiwan's strategic attempt to diversify its trade and investment to other emerging markets, as well as its pursuit of a balanced, fairer, and reciprocal cross-Strait relationship.

**Keywords:** New Southbound Policy, Trade War, Economic Security, Innovation Diplomacy, Warm Power

When it comes to the origins of Taiwan government's introduction of the so-called "New Southbound Policy" (NSP) more than two years ago, attention must be paid to the evolution of cross-Strait relations over the past three decades. Facing China's constant political, diplomatic, and military pressure and its economic seducement, Taiwan has been caught up with striking a balance between two sides of the Taiwan Strait while, at the same time, trying to manage and normalize cross-Strait trade and investment. Despite different governments having adopted diverse strategies to deal with it, the Democratic Progressive Party (DPP) government has treated the issue of economic security as more of a matter of Taiwan's national security.

## I. Strategic Thinking behind the New Southbound Policy

Since mid-1990s, there has been a “Great Debate” in Taiwan society regarding the way to pursue a balanced cross-Strait economic relationship. President Tsai Ing-wen’s predecessors all have introduced different strategies to address China’s economic security challenges to Taiwan. As China became a rising economic power in Asia in late 1990s, the Kuomintang government under former President Lee Teng-hui adopted a “caution and self-restrain” policy to react to the growing interest of Taiwanese investment in the Chinese market. Lee and his administration also featured the first wave of “moving south policy,” aimed at diversifying Taiwan’s foreign investment and avoiding being trapped in the Chinese market.

During the heyday of cross-Strait economic and trade relations under former President Chen Shui-bian’s administration from 2000 to 2008, the DPP government implemented a policy of “proactive opening and effective management” to regulate the scope and pace of Taiwanese investment to China due largely to geographic proximity and language and cultural closeness. This policy eventually resulted in almost 40% of Taiwan’s investment flowing to the other side (including Hong Kong). This reality has made Taiwan overdependent on the Chinese market.

When serving as president from 2008 to 2016, Ma Ying-jeou fast-tracked cross-Strait trade engagement by first negotiating and signing the *Economic Cooperation Framework Agreement* (ECFA) with his Chinese counterpart then pushing forward the *Service and Trade Agreement*. The latter effort was not trusted by Taiwan social forces who feared its sovereignty would be sabotaged by Beijing.

When Tsai took office in 2016, her administration officially launched the NSP policy as a national security strategy to diversify Taiwan’s trade outreach and deepen its ties with countries in Southeast Asia, South Asia, Australia, and New Zealand.

In her National Double-ten Day Address on October 10, 2018, President Tsai Ing-wen stated clearly that “the challenges that Taiwanese face are not limited to military threats, but also include diplomatic oppression, social infiltration and economic insecurity. The task at hand is to establish a comprehensive strategy and commence with efforts to strengthen national security.”<sup>1</sup>

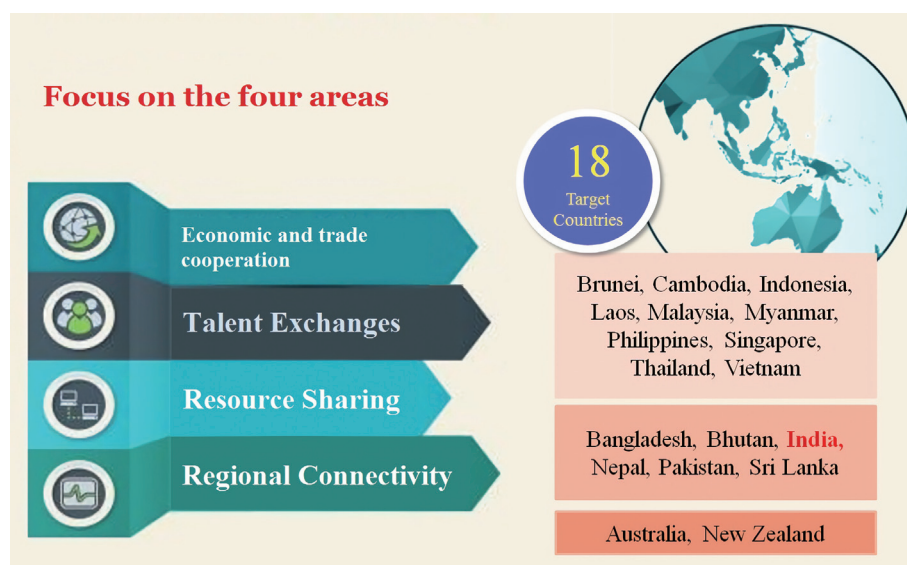
The Tsai administration recognizes three structural changes to cross-Strait economic relations. First, the rising wages and changes to the investment environment in China have forced more Taiwanese companies to think about relocating to new markets outside China. Second, the emergence of potential markets in Southeast and South Asia provides Taiwan with more investment opportunities and chances of upgrading Taiwan's traditional industrial structure. Third, Taiwan needs to explore other ways of engagement with countries other than China to avoid being isolated internationally.

To be economically secure, Taiwan must explore opportunities for cooperation with like-minded partners to pursue economic and entrepreneurial opportunities that were available to our forefathers. Such economic security readily translates into national security because it is only through an enduring economic prosperity and people-to-people engagement where we will find the growth, resources, and technological innovations necessary to bring Taiwan the world.

Therefore, the NSP consists of four goals: economic and trade cooperation, talent exchanges, resource sharing, and regional connectivity. It emphasizes a people-centered approach to broaden substantial engagement. It includes countries like Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam, Bangladesh, Bhutan, India, Nepal, Pakistan, Sri Lanka, Australia, and New Zealand (See Figure 1).

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1. Office of the President, Republic of China (Taiwan), "President Tsai delivers 2018 National Day Address," October 10, 2018, *Office of the President, Republic of China (Taiwan)*, <<https://english.president.gov.tw/News/5548>>.



**Figure 1. Key Goals and Target Countries of New Southbound Policy**

Source: Made by Taiwan External Trade Development Council (TAITRA).

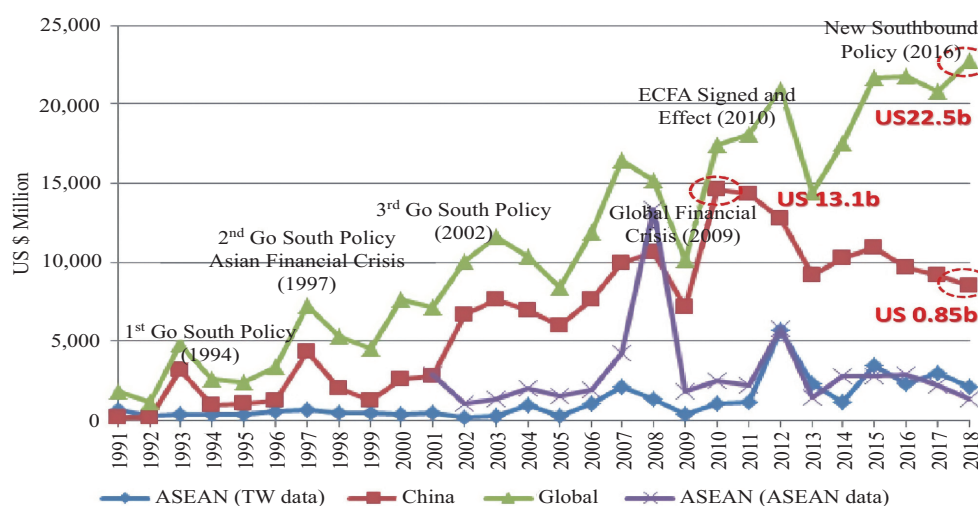
From the perspective of trade and investment, the latest wave of Taiwan’s “moving south” policy aims at further diversification. Based on different sectors, the previous waves of “moving south” primarily targeted countries like Thailand, Vietnam, Malaysia, the Philippines, and Indonesia (See Table 1). The NSP policy focuses more on new emergent markets, such as India, Cambodia, and Burma.

**Table 1. Taiwanese Investment in the New Southbound Target Countries (2019)**

Country	Numbers of Companies	Main Investment Industries
Thailand	4,600	Basic Metal Manufacturing, Textiles, Finance and Insurance
Vietnam	5,000	Finance and Insurance, Electronic Parts and Components, Computers, Electronic and Optical Products
Malaysia	1,700	Finance and Insurance, Textiles, Wood and Bamboo Products
Philippine	250	Finance and Insurance, Textiles, Electronic Parts and Components, Computers
Indonesia	2,000	Textiles, Footwear, Furniture

Source: Made by TAITRA.

Even before the introduction of NSP two years ago, there has been an incremental decline of Taiwanese investment in the Chinese market both in terms of the numbers of companies as well as the volume of capital (See Figure 2).



**Figure 2. Recent Changing Pattern of Taiwan's Outbound FDI**

Source: Made by Dr. Kristy Hsu.

The red dashed line represents Taiwan's outbound FDI to China from 1991 to 2018. It displays a step-by-step decrease of FDI to China since 2010 despite some fluctuation in 2015. In the most recent years, on the other hand, Taiwan FDI toward the ASEAN market has been quite steady.<sup>2</sup>

## II. Structural Changes to Cross-Strait Economic Relationship

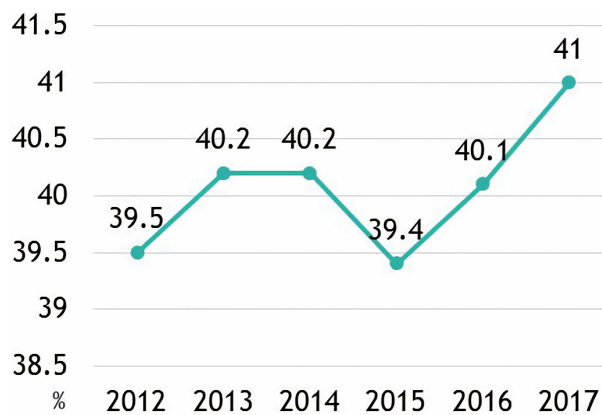
The main reasons contributing to the gradual retreat from Chinese markets are multifaceted. Rising labor wages, together with stricter rules to tackle environmental and pollution issues, have forced more Taiwanese companies to ponder pivoting to other markets. Moreover, the stagnation of the current political relationship between Taiwan and China also creates uncertainties for Taiwanese business. The ongoing

2. Data collected by Dr. Kristy Hsu in October, 2019. Dr. Hsu is associate research fellow and Section Chief of the Taiwan WTO Center, and Program Coordinator of the Taiwan ASEAN Studies Center(TASC), Chung Hua Institution for Economic Research (CIER).

deterioration of U.S.-China trade issues only accelerates the trend of Taiwanese companies pulling their business out of China or establishing alternatives outside China.

Before the outbreak of U.S.-China trade confrontation, 40% of Taiwan’s exports were flowing into China (including Hong Kong). Taiwan’s top investments in China are: electronic components (20.7%), non-metallic mineral products (12.2%), financial and insurance (11.6%), and computer and electronic products and optics (11.6%).

According to the Ministry of Commerce of China, 3.4% of China’s total inbound foreign investment came from Taiwan. Taiwan is China’s 2<sup>nd</sup> largest foreign investor. Taiwan is also China’s top overseas investment destination. Nevertheless, according to the Investment Commission of Taiwan, total investment by Taiwan companies in China has been declining since its peak in 2010. The number of investment projects in China has been declining since the peak in 2003, too (See Figure 3 & Table 2).



**Figure 3. Before the Outbreak of U.S.-China Trade War**

Source: Made by TAITRA.

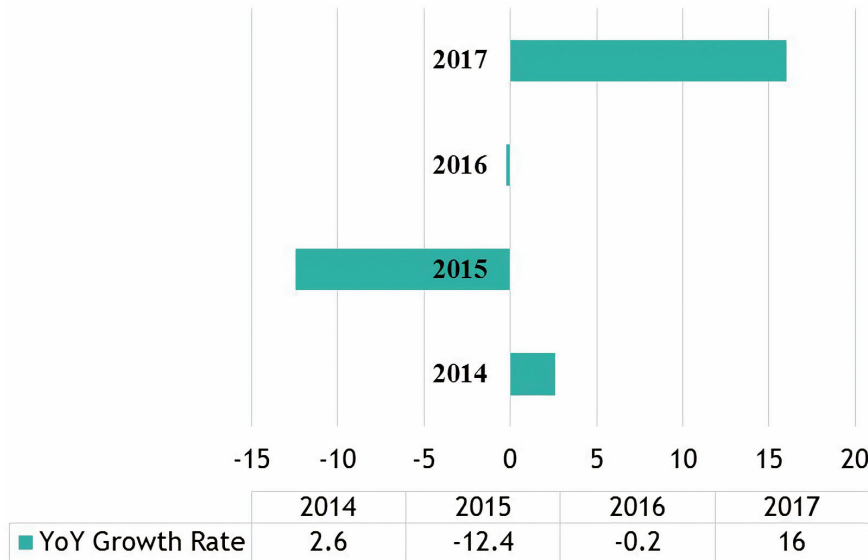
**Table 2. Taiwan’s Top Investments in China**

Category	Electronic Components	Non-metallic mineral products	Financial and Insurance	Computer and electronic products and Optics
%	20.7	12.2	11.6	11.6

Source: Made by TAITRA.

### III. Initial Impact of U.S.-China Trade Friction on Taiwanese Business in China

Ever since the Trump administration launched the trade war with Beijing in 2018, the Taiwan government has been studying the impact it might have on Taiwanese enterprises in China. According to the investigation conducted by the Taiwan External Trade Development Council in November and December 2018, there has been limited impact, based on Taiwan's export figures. Taiwan's exports to the U.S., Europe, Japan, China (including Hong Kong), and ASEAN have remained stable. Taiwan's exports to the NSP markets also grew 4.8% in late 2018. (See Figure 4 & Table 3)



**Figure 4. Annual Growth Rates of Taiwan Exports to China**

Source: Made by TAITRA.

**Table 3. Growth Rates of Taiwan Exports to the World (October 2018)**

Country	YoY Growth %
The U.S.	27.0%
Europe	11.5%
Japan	9.5%
China (including Hong Kong)	9.1%
ASEAN	14.2%
New Southbound markets (18 countries)	4.8%

Source: Made by TAITRA.

According to TAITRA's survey, there were mixed results and complicated reactions from the Taiwanese companies operating in China.<sup>3</sup> For example, some companies focused on the China domestic market are less affected. Other companies that already had adopted a "hedging" strategy by opening alternative operation centers in ASEAN markets were benefited by shifted orders from their American buyers. More U.S. companies shifted orders from China to Southeast Asia and Taiwan.

Most importantly, the fact that laptop and smart phone devices and components have not been included in the tariff list by the Trump administration has been quite a relief to Taiwanese companies manufacturing those products. Hence, the majority of Taiwanese companies have decided to wait and see. Nevertheless, there has been a slight increase in exports of intermediate goods from Taiwan to Southeast Asia.

The trade war has had more psychological shock on Taiwanese companies in China despite uncertainties remaining between Washington and Beijing. Since the

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3. Since November 2018, TAITRA has conducted a series of survey on the impact of U.S.-China trade friction on Taiwan's overall economy. The latest report was completed August 2019. It is a collaborate work done by TAITRA's Bureaus of Market Expansion, Industrial Expansion, Marketing and Exhibition.



transformation of cross-Strait economic and trade relations started before the trade war and Taiwanese investment in China has continued to decline over the past eight years, the trade war only has sped up the pace of realignment of cross-Strait supply chain. More Taiwanese companies have decided to relocate their business southbound. Some have ended up returning to Taiwan or at least opening new assembly lines in Taiwan. There has been a tendency towards risk diversification by Taiwanese companies to avoid “putting all eggs in one basket.”

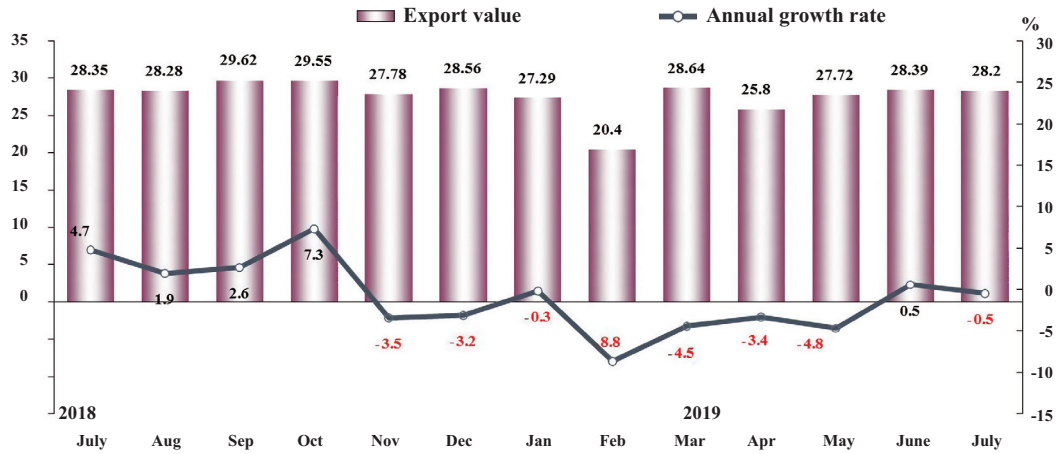
U.S. President Trump and Chinese leader Xi Jinping reached a 3-month truce in Buenos Aires last December on the sidelines of the G20 summit. Both leaders agreed not to boost tariffs on \$200 billion of Chinese goods from 10% to 25% in 2019 for 90 days. Nevertheless, the general perception is that there will be a prolonged trade war between Washington and Beijing. This has grown to include competition over future technology supremacy and world leadership.

The impact of U.S.-China trade became more salient in the first half of 2019. From January to July, Taiwan's exports to China decreased 8.3%. In contrast, Taiwan's exports to the U.S. grew 18%. Taiwan's export value also has been declining since November 2018 due to uncertainties of the trade war and global economic slowdown (See Table 4 & Figure 5).

**Table 4. Effect of U.S.-China Trade War on Taiwan's Exports (1)**

	2018			2018 (July-Dec.)			2019 (Jan.-July)		
	Value (billion USD)	Portion (%)	Growth (%)	Value (billion USD)	Portion (%)	Growth (%)	Value (billion USD)	Portion (%)	Growth (%)
Global	335.9	100	5.9	177.2	100	1.5	186.4	100	-3
China	96.8	28.8	8.7	50.3	29.2	2.7	49.8	26.7	-8.3
US	39.7	11.8	7.5	20.9	12.1	6.9	26.1	14	18
ASEAN	58.2	17.3	-0.6	29.1	16.9	-5.3	30.9	16.6	-9.3
EU	29.5	8.8	8.4	14.7	8.6	3.4	16.2	8.7	-5
Japan	23	6.9	11.1	11.8	6.9	7.7	13.3	7.2	0.2

Source: Made by TAITRA.



**Figure 5. Effect of U.S.-China Trade War on Taiwan’s Exports (2)**

Source: Made by TAITRA.

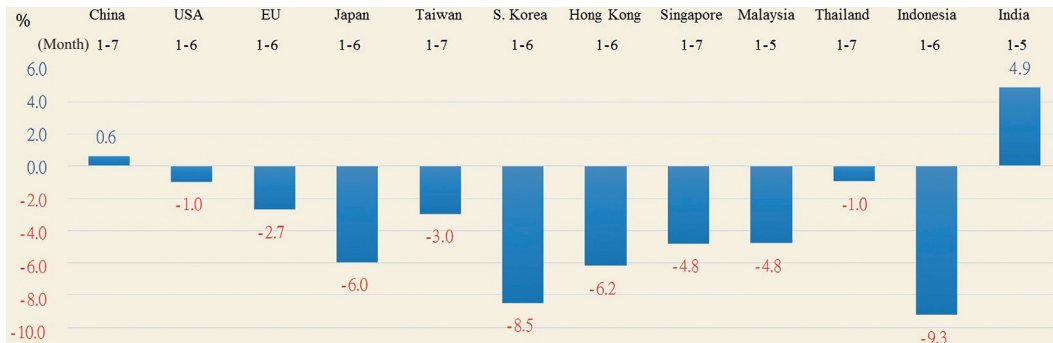
Note: Export value began to decline in November 2018 due to uncertainties of trade war and global economic slowdown.

In early May 2019, President Trump accused his Chinese counterparts of violating the first draft of a trade agreement and decided to raise tariffs on \$200 billion worth of Chinese goods. He also threatened to tax nearly all of China’s imports.<sup>4</sup>

Trump’s move in May could be seen as a plan to exert more pressure on Xi Jinping to make concessions a month later on the sidelines of the G20 Summit in Osaka, Japan. Nevertheless, the renewed deadlock between Washington and Beijing has shocked global markets and created more uncertainty in the power play between the world’s two largest economies.

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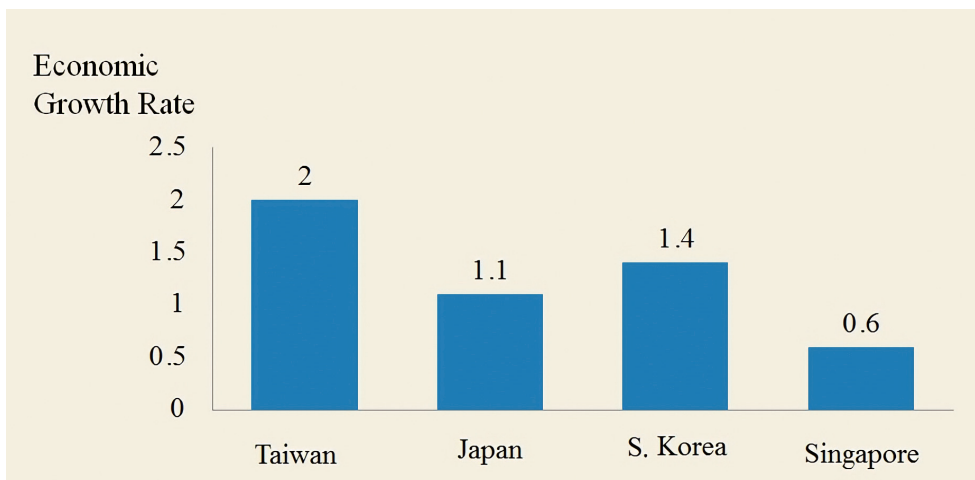
4. Ana Swanson & Alan Rappeport, “Trump Increases China Tariffs as Trade Deal Hangs in the Balance,” *The New York Times*, May 9, 2019, <<https://www.nytimes.com/2019/05/09/us/politics/china-trade-tariffs.html>>.



**Figure 6. Export Growth Rate 2019**

Source: Made by TAITRA.

The good news for Taiwan, however, is that its economy remains the strongest among the major Asian economies, as indicated by the economic growth performance (See Figure 7).



**Figure 7. Economic Growth of Major Asian Economies (2019 Q1 & Q2)**

Source: Made by TAITRA.

Note: According to the Executive Yuan of Taiwan's government, Taiwan enjoys a higher economic growth rate than the major Asian economies. The projected growth rate for Taiwan is 2.46%. The IHS Markit estimates Taiwan will sustain a 2% economic growth rate.

Having said that, Taiwan government has been observing and reacting to the intensification of U.S.-China trade frictions cautiously. There have been more in-depth

analyses on the potential impact of the trade war on different sectors. This has shown there has been significant impact on networking equipment, bicycles, and bicycle parts. On the other hand, computers, electronics, and optical lens makers have benefited from order-transfer effect and returning production (production rose 16.5% in the first quarter of 2019).

Taiwan's electronics and consumer goods industries are connected tightly to the global supply chain, so Taiwanese companies operating in China and Taiwan's exports to China are experiencing significant impact. This is accelerating a supply chain reshuffle. A majority of industries have deployed adaptive measures to the change.

#### **IV. Taiwan Government's Response Measures**

Facing the growing anxiety among Taiwanese businesses in China to react to the trade war, the Taiwan government has adopted four key response measures to ensure Taiwan's economic security.

First, a government taskforce was formed to resolve land, tax, and other regulatory issues for overseas Taiwanese companies relocating production back to Taiwan. The Cabinet introduced an Action Plan to Welcome Overseas Taiwanese Business Return to Invest in Taiwan early this year. By October 2019, nearly 150 companies have been approved by Taiwan's Ministry of Economic Affairs to relocate their business back home. Promised investment funds have exceeded US\$20 billion.

Most of the companies returning to Taiwan are in ICT-related sectors, which require less labor, with a few manufacturing sectors to add assembly lines. Most importantly, Taiwan has encouraged the return of Taiwanese companies to meet with the government's pilot programs of "5 plus 2." The "5 plus 2" program includes the Asian Silicon Valley, smart machinery, biochemical, defense industry, green energy, new agriculture, and circular economy.

Second, the government has made extra effort to assist Taiwanese companies in pivoting to the NSP markets. In light of the worsening trade war, the NSP launched in 2016 has proven to be a forward-looking strategy for navigating alternative markets opportunities for Taiwanese businesses. The policy helps production relocation and

enhances competitiveness for Taiwanese companies.

Third, the government also utilizes the NSP to expand cooperation with the Trump administration's Indo-Pacific strategy, as well as European Union's initiative to strengthen "EU-Asia Connectivity." Since the Indo-Pacific strategy highlights the importance of cooperation in areas of digital economy, energy, and infrastructure and the "EU-Asia Connectivity" also emphasizes the need for people-to-people engagement, it paves the way for deepening Taiwan's ties with the U.S. and Europe. This also is helpful for Taiwan in assisting its businesses toward market diversification.

Fourth, the ultimate goal of the NSP is to build momentum for Taiwan to negotiate bilaterally and multilaterally to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). It also will forge Taiwan's existing role in the Asia Pacific Economic Cooperation (APEC) and the World Trade Organization (WTO).

## V. Taiwan's Efforts to Explore the India Market

Among the 18 NSP countries, India stands out as an interesting case. India's potential of being the next economic power generally is acknowledged. Most international forecasts have stated that India will be able to maintain an average economic growth rate of more than 7% over the next two decades.

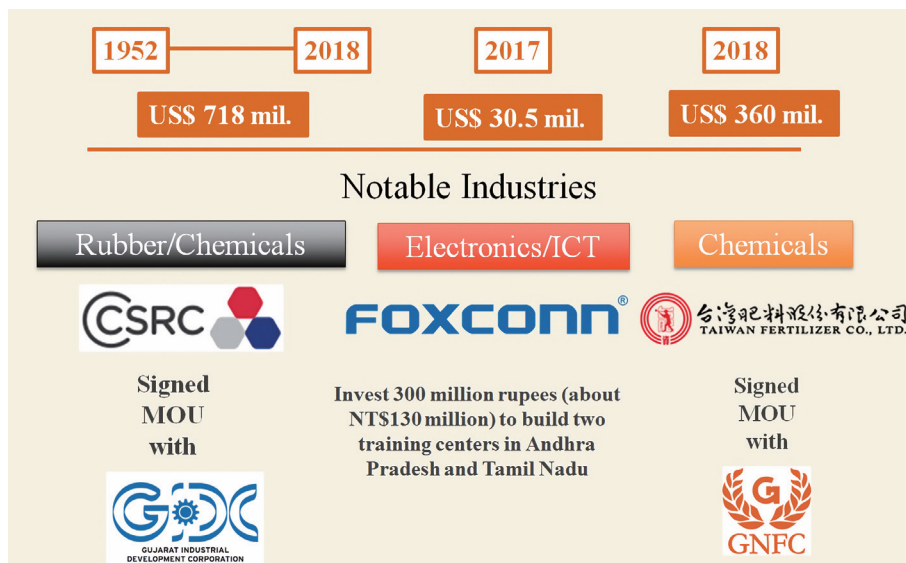
The International Monetary Fund's (IMF) estimated India's economy is set to grow at 7.0% in 2019, picking up to 7.2% in 2020.<sup>5</sup> The Economic Times projects India's economy to grow 7.3% in 2019 and 7.5% in 2020. A G-20 surveillance note expects India's economy to grow 7.3% in 2019 and 7.5% in 2020. The note said recent manufacturing indicators point to a tentative rebound in Asian and Latin American countries except India.<sup>6</sup>

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5. International Monetary Fund, "Still Sluggish Global Growth," July 23, 2019, *International Monetary Fund*, <<https://www.imf.org/en/Publications/WEO/Issues/2019/07/18/WEOupdateJuly2019>>.

6. Kirtika Suneja, "India's Economy to Grow 7.3% in 2019, 7.5% in 2020: G-20 Note," *The Economic Times*, June 6, 2019, <<https://economictimes.indiatimes.com/news/economy/indicators/indias-economy-to-grow-7-3-in-2019-7-5-in-2020-g-20-note/printarticle/69675612.cms>>.

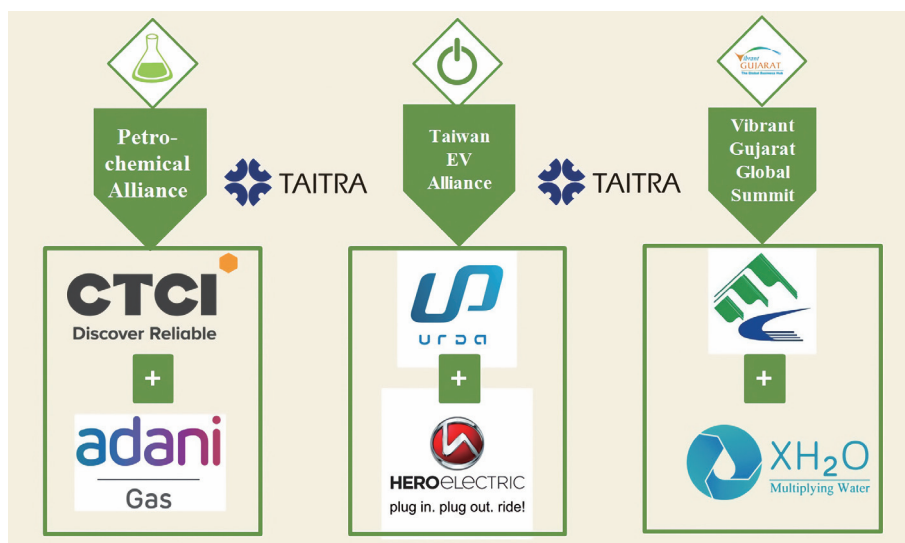
Taiwan’s investment in India over the past six decades only has resulted in U.S. \$718 million. In the single year of 2018, the number climbed to U.S.\$360 million. More notable Taiwan companies have invested in India over the past two years (See Figure 8).



**Figure 8. Taiwanese Investment in India**

Source: Made by TAITRA.

Through TAITRA’s connection, major achievements have been made between Taiwan and India, namely, petrochemical cooperation, a joint venture on electric vehicles, as well as smart city initiatives (See Figure 9).



**Figure 9. Notable Promotional Efforts by TAITRA in India**

Source: Made by TAITRA.

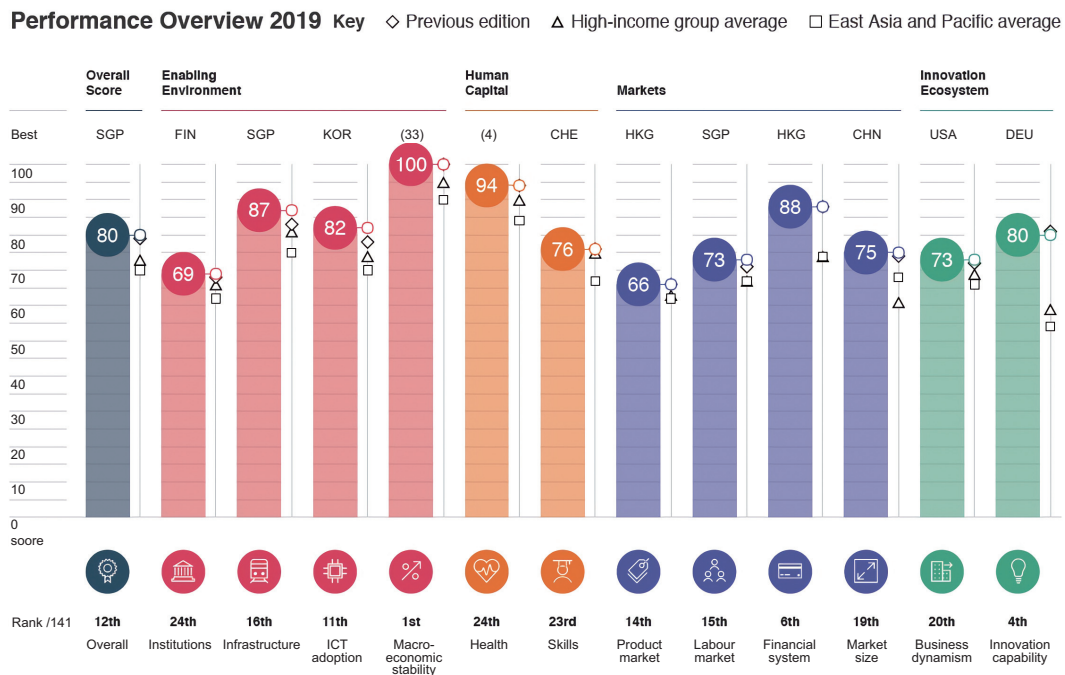
To look on the brighter side, there is considerable room for improvement between Taiwan and India. Despite forging political ties still being sensitive, both countries can deepen bilateral economic ties as a way to adapt to a global downturn.

## VI. Taiwan's Innovation Diplomacy

In addition to pushing forward the NSP, it is also imperative for Taiwan to incorporate more creative strategies to safeguard its economic security.

Innovation is in Taiwan's DNA. Taiwan possesses huge talent in innovation and technology. The Taiwan government has made tremendous effort to transform its industrial structure toward a technology and innovation driven future. The effort has won worldwide recognition. In its *Global Competitiveness Report 2019*, the World Economic Forum (WEF), based in Switzerland ranked Taiwan 12<sup>th</sup> in terms of its overall national competitiveness among 141 economies, and Taiwan is 4<sup>th</sup> in the Asia-pacific Region. Moreover, Taiwan, together with Germany, Switzerland, and the U.S., have all been characterized as the world's four "super innovators"<sup>7</sup> (See Figure 10).

7. Klaus Schwab, *The Global Competitiveness Report 2019* (Geneva: World Economic Forum,



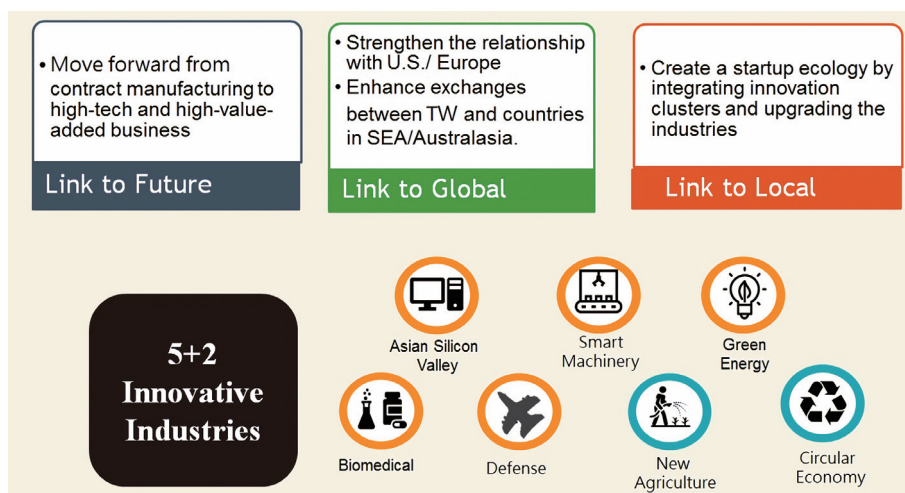
**Figure 10. Performance Overview 2019 (Taiwan)**

Source: Klaus Schwab, *The Global Competitiveness Report 2019*, p. 538.

Taiwan must incorporate “innovation diplomacy” as a supplementary strategy to its official diplomacy. The goals are to move forward from contract manufacturing to high-tech and high-value-added business and strengthen the relationship with the U.S., Europe, and NSP countries. Most importantly, there is also a need to create a startup ecology by integrating innovation clusters and upgrading industries (See Figure 11).

2019), p. 538, *World Economic Forum*, <[http://www3.weforum.org/docs/WEF\\_TheGlobalCompetitivenessReport2019.pdf](http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf)>.





**Figure 11. Strategic Goals of Taiwan's Innovation Diplomacy**

Source: Made by TAITRA.

In order to inject new blood in the startup sectors, Taiwan's government has adopted measures to adjust the land tax and housing tax for the rise of mobile and digital business. To reduce foreigners' burden, Taiwan has improved the medical environment and created a friendly legislative environment for Digital Business. Other measures, such as relaxation of the procedure for clearance of Imported and Export Goods and speeding up the procedure for foreigners to apply for permanent residency, all aim at attracting professional foreigners to Taiwan. The Cabinet also passed an Act for the Recruitment and Employment of Foreign Professionals to help attract and retain foreign professionals.

The Cabinet submitted a draft *New Economic Immigration Law* on November 29, 2018, to the Legislative Yuan. The purpose is to address the challenges associated with an aging population and growing shortage of skilled human resources.

## VII. The NSP as Taiwan's Warm Power

Entering its third year, the 2019 Yushan Forum, centered on "Deepening Progressive Partnerships in Asia," was held in Taipei. The forum serves as the main platform to further deepen people-to-people engagement with NSP partners. This year's forum attracted foreign diplomats, NGOs, academics, ex-government officials, and young

talents to showcase Taiwan's "warm power." There are at least three main features of "warm power" that Taiwan would like to promote through the NSP.<sup>8</sup> First, Taiwan wants Asian neighbors to feel the goodwill and warmth of the Taiwanese government and people. The NSP focuses on innovative industry, talent cultivation, social interaction, medical cooperation, agricultural development, and cultural exchanges.

Second, Taiwan has worked to connect NSP partner countries with these sectors and forces in Taiwan as a way to create innovative partnerships. Recognizing Taiwanese potential young talents, the NSP provides a platform for Taiwan's civic organizations, NGOs, and young entrepreneurs to forge closer partnerships in the Asian community.

Third, with the reinforcement of such people-to-people connectivity, Taiwan hopes to establish multi-lateral frameworks and long-term mechanisms for engaging Asian partners.

## VIII. Conclusion

To conclude, as the Taiwan government's pilot plan to safeguard its economic security and strengthen people-to-people engagement with like-minded countries, the NSP hopes to make Taiwan a better partner with the world in many aspects.

Facing China's constant and multilateral approach to swallow Taiwan internationally and annex Taiwan through political and economic means, the launch of the NSP by the Tsai administration more than two years ago has proven to be a forward-looking vision and preventive diplomacy. If Taiwan had continued to be locked up in the Chinese market, it would have been more difficult for Taiwanese companies to avoid the impact of the trade confrontation between Washington and Beijing.

Taiwan is not the only country adopting such a hedging strategy. The Koreans, Japanese, Australians, and Indians are as well. There has been a convergence of trade, investment, people-to-people engagement, and cooperation by most countries in the

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8. Alan H. Yang & Ding-liang Chen, "The Yushan Forum and Taiwan's Warm Power," October 18, 2019, *Foreign Policy Research Institute*, <<https://www.fpri.org/article/2019/10/the-yushan-forum-and-taiwans-warm-power/>>.

same area and markets.

The complicated nature of global power competition and the continued U.S.-China trade confrontation further enables Taiwan's NSP to be seen as a valuable platform and strategic asset for building up close partnerships. Taiwan must seize the window of opportunity along with other like-minded countries.

