Exploring the Next Taiwan Government's Cross-Strait Economic and Trade Policies in the Context of Mainland China's Economic Climate

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The current tense international political and economic landscape has presented cross-strait economic and trade relations with unprecedented challenges and opportunities. The pandemic has fundamentally reshaped the global economic landscape and intensified tensions between the United States and China, significantly impacting cross-strait exchanges. In light of the upcoming inauguration of Taiwan's new government, it is necessary to reassess and modify policies toward mainland China to address the downturn in its economic outlook, the escalating tensions between the United States and China, and the economic pressures imposed by mainland China on Taiwan.

First, cross-strait economic and trade relations have been impacted by the deepening economic risks confronting mainland China in recent years. These include bubbles in the real estate market, continuously escalating debt levels, subdued domestic demand, and uncertainties in the external environment. Urbanization has driven real estate prices to soar, yet overdevelopment has resulted in an oversupply, ultimately sparking a series of financial crises among major developers. This underlies one of the current principal risks which challenging to mitigate in the short term, leading to a prolonged effect on market confidence. Furthermore, since 2017, the growth rate of local government debt balances has significantly outpaced the nominal economic growth rate, resulting in a sharp increase in the debt ratio. This has placed immense pressure on local finances, compelling them to reduce spending and investment, which directly impacts economic momentum.

Mainland China is grappling with weak investment and diminishing consumer confidence, primarily attributed to the downturn in the real estate market, which has led to a significant rise in non-performing loans for financial institutions and a hit to investor confidence. This, in turn, affects the overall financial stability and economic health of the country. The year-on-year growth rate of urban fixed asset investment has decelerated for ten consecutive months, with private investment experiencing negative growth for eight consecutive months. The decline in domestic consumer confidence directly impacts the revival of the retail and service sectors, inhibits income growth, and introduces uncertainty into the job market. This sluggish domestic demand not only hampers economic growth but also presents a substantial challenge to the pace of economic recovery.

In recent years, a growing number of institutional investors or international organizations have adopted pessimistic prospects of mainland China's economy. For instance, the International Monetary Fund (IMF) [1] decreased mainland China's expected GDP growth rate to 3.5% by 2028. The Japan Center for Economic Research (JCER) [2] declines its projects to 1.5% by 2029 with a more bleak point. Moreover, mainland China continues to confront deflationary pressures. Without effective measures to invigorate sluggish domestic demand, mainland China risks entering a challenging scenario, characterized by persistent price declines and limited momentum for GDP growth.

Second, the long-term tension in US-China relations keeps affecting cross-strait economic and trade relations. Amid the US' trade and technology blockade, mainland China's emphasis on enhancing its national security has led to the withdrawal of foreign firms, further locally diminishing manufacturing capacity, employment, and export levels. To cope with the impact of its economic downturn, mainland China has actively developed emerging industries, especially in the "new three" products, including lithium batteries, electric vehicles, and solar cells. In 2023, financial subsidies from state-owned banks facilitated capital expansions in metal smelting, automobile manufacturing, and electrical equipment industries, which grew by 10%, 18%, and 34% respectively. However, this expansion of manufacturing capacities raises concerns about the potential triggering of a new round of trade wars, leading to increased trade frictions.

The intensification of US-China economic and trade disputes has disrupted the triangular trade model long operated by Taiwanese firms. On one hand, Taiwan-based firms in mainland China have relocated to Southeast Asia or other emerging economies to establish additional factories, aligning with US strategic interests and mitigating investment risks through more diversified production sources. On the other hand, as their supply chain shifts towards international destinations, Taiwanese businesses are encountering severe price competition.

After the presidential election in Taiwan, mainland China's overarching policy towards Taiwan has remained largely unchanged, yet there have been shifts in its detailed strategies and practices. On one hand, to apply economic pressure on Taiwan, mainland China has gradually phased out the early harvest benefits under the Economic Cooperation Framework Agreement (ECFA), while continuing to support Taiwanese firms investing in the mainland. Mainland China's economic and trade policy towards Taiwan can be encapsulated in three main strategies: accelerating import substitution, fostering industrial clustering, and prioritizing quality investments. Concurrently, this approach compels local Taiwanese firms engaged in low-end manufacturing to pursue upgrades, transformation, or relocation. Additionally, it is supplemented by local policies such as Fujian's "Cross-Strait Integration Development Demonstration Zone" to continue attracting talent and technology from Taiwan.

In view of the current dynamics, we propose several strategies for cross-strait economic and trade policies: Firstly, preserving a competitive edge in key industrial technologies; secondly, sustaining the vertical competitive dynamics within cross-strait supply chains to circumvent excessive dependence on mainland China's domestic market; thirdly, strengthening diversified supply chains beyond cross-strait outsourcing initiatives; and fourthly, in reaction to the mounting economic risks in mainland China and potential threats to Taiwan's economic stability, it is imperative for Taiwan to enhance its strategy for economic resilience. Ultimately, the goal of maintaining stable economic and trade interactions is to mitigate the risk of political misjudgments.

Note:

1. International Monetary Fund (2024). IMF Executive Board Concludes 2023 Article IV Consultation with the People's Republic of China. https://www.imf.org/en/News/Articles/2024/02/01/pr2433-china-imf-executive-board-concludes-2023-article-iv-consultation

2. Japan Center for Economic Research (2023). China's Growth Rate Below 3% after 2029. https://www.jcer.or.jp/english/chinas-growth-rate-below-3-after-2029