

4 Taiwan in the high-income trap and its implications for cross-Strait relations

Syaru Shirley Lin

Background to Taiwan's double bind

After decades of impressive growth, Taiwan achieved the status of 'high-income economies,' according to the World Bank's definition of approximately \$12,000 gross national income per capita, more than three decades ago.¹ In so doing, Taiwan experienced an economic miracle. It not only built a high-income society with a solid middle class, avoiding the middle-income trap that has plagued so many other emerging economies. But even more miraculously, the majority of Taiwanese, ordinary workers and elites alike, benefited from increasing prosperity creating an unusually high degree of equality compared with other economies making the same transition. During its evolution from middle-income to high-income status, Taiwan relied primarily on the export of more highly valued products. But today Taiwan can no longer compete with countries that are catching up technologically, but still enjoy lower labour costs. Taiwan also finds it difficult to promote innovation or upgrade to still higher value-added services in order to provide the economic benefits that a wide spectrum of society has come to expect. Overall, established economic patterns fail to satisfy expectations of the voters, whether in aggregate or per capita terms. Furthermore, Taiwan also became a new democracy, and the top-down industrial policy-led economic planning of the past gave way to a more consensus-driven way of policy-making.² Such participatory politics in a highly democratic society has made it difficult to make the necessary economic trade-offs among policy alternatives, often leading to political gridlock or oscillating policies. The latest trade-off, for example, is the classic one of 'guns vs. butter,' because the pressure to invest more in the military to keep up with the Chinese threat complicates Taiwan's ability to meet these other socio-economic priorities (Newsham 2020).

Like its other East Asian neighbours, Taiwan's growth dropped from double digit in the 1960–80 to single digit from 1988 to now, except for 2010 in the aftermath of the global financial crisis. More importantly, wages have stagnated for two decades except for some high-skilled workers. Ever since Taiwan reached the high-income status, it has struggled to remain competitive.

This coincided with cross-Strait two-way trade (excluding Hong Kong) growing to become over a fifth of Taiwan's total trade from 2008 onwards, with exports to China reaching an all-time high in 2018 to constitute 29% of Taiwan's total exports. Furthermore, the majority of Taiwan's cumulative foreign direct investments are still in China. In other words, Taiwan escaped the middle-income trap only to enter a high-income trap with structural problems that include an ageing population, wage stagnation, rising welfare entitlements, inflated housing costs, over-regulated markets, and what many regard as excessive dependence on China. Furthermore, inequality has widened, and social tensions and political unrest are increasing. As in other countries caught in the high-income trap, there is a perception that the 'other' – especially emerging markets and immigrants – are to be blamed for job loss, slower growth, and social problems. For Taiwan, however, the 'other' is primarily mainland China, whose insistence on eventual unification is seen as an existential threat to many Taiwanese, even though the large Chinese economy appears to others to be the most obvious solution for Taiwan's sluggish economic growth. This 'double bind' between fearing China yet being compelled to integrate with it economically has had important political implications in Taiwan's highly democratic environment. Voters have been dissatisfied with all the political parties, in terms of both the solutions they have proposed to stimulate growth and fairly distribute the gains, and their policies towards mainland China.

After former President Ma Ying-jeou of the Kuomintang (KMT) initiated a period of extensive liberalisation of cross-Strait economic relations under the flagship Economic Cooperation Framework Agreement (ECFA), signed in 2010, Taiwanese voters rejected such a strategy by voting overwhelmingly for the Democratic Progressive Party (DPP) to control both the executive and legislative yuans in 2016 and 2020. Because of the DPP's historical commitment to independence, and its refusal to reassert a commitment to unification with China, this has led to a cross-Strait stalemate, with Beijing making increasingly assertive efforts to penalise Taiwan economically, marginalise it internationally, and pressurise it militarily. Briefly in 2018, Taiwanese voters changed their minds and returned 15 KMT mayors out of 22 cities. However, the newly elected Kaohsiung mayor and 2020 KMT presidential candidate Han Kuo-yu's surprising emergence and sudden fall by a popular recall within two years, together with DPP president Tsai Ing-wen's landslide re-election in 2020, again signalled how quickly Taiwanese voters can change their minds. Nonetheless, Han's appeal – especially his advocacy of closer economic relations with China – highlights the importance of such an alternative in the debate on Taiwan's economic future.

These dramatic political developments have occurred in the context of the combination of Taiwan's deepening high-income trap, the rising power of China, and the consolidation of Taiwanese identity, especially among the youngest generations. The resulting double bind simultaneously pulls Taiwan both towards China and away from it. As Taiwan's political leaders face

increasing popular demands to escape from the high-income trap, expanding economic ties with China is an option that is economically compelling but politically untenable. This is because the island's citizens want to safeguard their Taiwanese identity against growing pressure from Beijing for unification. Thus, Taiwan's economic policy continues its historic pattern of oscillating between cross-Strait economic liberalisation and restriction (Lin 2016). While Taiwan has long experienced a version of this China dilemma, it is more acute for Tsai's administration than for any previous government because of the difficulty in diversifying Taiwan's economy to avoid deeper dependence on China and the prospect that a challenging global recovery from the 2020 pandemic will further dampen Taiwan's economic growth.

The first half of the double bind: Taiwan's high-income trap in the context of East Asia

Like many other high-income economies, Taiwan's attainment of high-income status paradoxically coincided with the start of an economic slow-down. The decline in growth is the basis of many of the related issues facing high-income societies. Reaching high-income status may have been difficult, but maintaining consistent rates of economic growth in order to retain that status and deliver welfare benefits to a broad spectrum of society – particularly health care, education, and retirement benefits – has proven even more challenging (Figure 4.1).

For nearly five decades after 1960, only 13 out of 101 economies graduated from the middle-income category to high-income status, and the five East

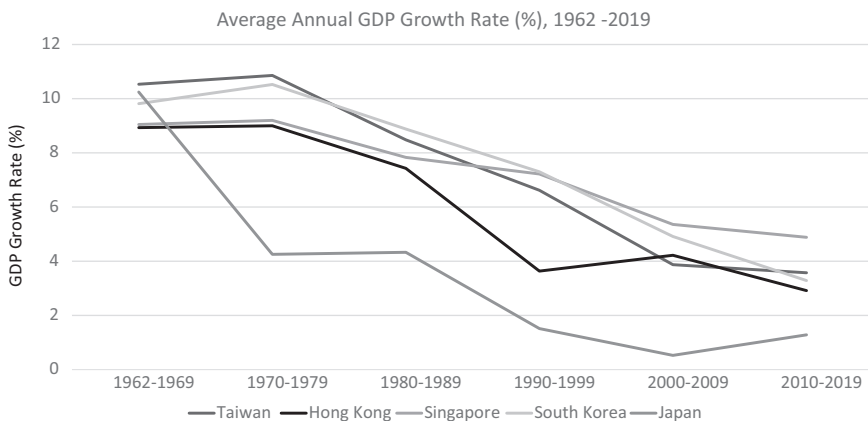


Figure 4.1 Average annual GDP growth rate by decade (– percent), 1962–2019.

Sources: All data from World Bank, *World Development Indicators*, except Taiwan's data from Directorate-General of Budget, Accounting and Statistics, Executive Yuan, Republic of China (DGBAS).

Asian economies were the poster children, especially if viewed from a real GDP per capita measured by purchasing power parity.³ More countries in recent years have joined the high-income ranks and have remained there, including Chile, the Czech Republic, Estonia, Poland, and Uruguay. However, several other countries that attained high-income status have been unable to stay there, moving in and out of the category. Croatia, Hungary, and Latvia fell out but rejoined, while Russia, Argentina, and Venezuela came in, but have subsequently been downgraded to upper-middle-income status, where they are now competing with other countries in that status such as Malaysia, Kazakhstan, and Turkey which are quickly moving up the ladder.⁴ Having finally reached high-income status, countries like Taiwan must find a sustainable path forward. Unless they can continue to grow at a consistent rate, they may stall economically or even fall back. Continued growth may be necessary to meet rising demand for more benefits, maintain national status and military capability. Economically, studies have shown that inequality inhibits further growth (Ostry 2014). Furthermore, the social and political implications of the high-income trap for the middle class in these wealthy societies are far reaching, since uneven distribution in favour of the elites leads to political alienation, and growing support for extreme political platforms. Faced with rising inequality and high youth unemployment, these societies are becoming more polarised as they search for potential solutions.

More fundamentally, the structural factors which have led these economies into the high-income trap are not easily addressable in the short term (Manyika et al. 2015). Although troubled more by deflation than asset inflation, Japan, the first East Asian country to enter the trap, remains deeply enmeshed in slow growth, demographic decline, and debt. Other advanced economies in Asia, like Taiwan, South Korea, Hong Kong, and Singapore, as well as their counterparts in the West, have also suffered from their own versions of the high-income trap. Since 2015, all five Asian economies grew between only 2% and 4% (Figure 4.2). With estimated 2.7% GDP growth in 2019, Taiwan was actually the best performing economy in this group. But with the COVID-19 crisis, all of them are projected to contract, including Taiwan whose growth may decline by as much as 4%, according to the IMF.⁵

During its eight years in office, Ma Ying-jeou's government did make a serious effort to address the deep structural problems confronting Taiwan's economy. But Ma's solution relied on doubling down on economic integration with mainland China both to ensure cross-Strait stability and to stimulate Taiwan's economy. During his administration, Ma tried to mollify Beijing in order to maintain a stable economic environment, encouraging more two-way trade with China as well as permitting Chinese investments in Taiwan. Ma reaffirmed the '1992 Consensus,' which acknowledged that Taiwan was part of China and committed Taiwan to eventual unification with the mainland. He also met China's President Xi Jinping in Singapore just a few months before Taiwan's January 2016

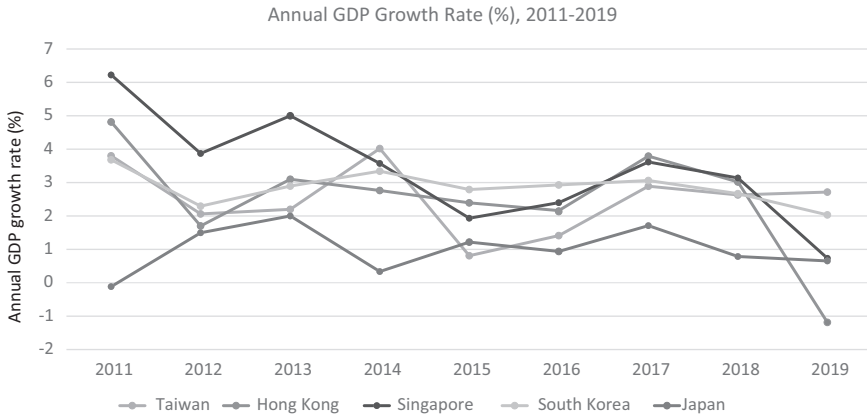


Figure 4.2 Annual GDP growth rate for East Asia (– percent), 2011–19.

Sources: All data from World Development Indicators, World Bank except Taiwan’s data from DGBAS.

presidential election, the first Taiwanese president to meet with his mainland counterpart (Lin and Chung 2018). But the economic results of this strategy were unspectacular: GDP growth rate dropped to under 2% in Ma’s last two years in office and Taiwan’s trade surplus with China also fell to a ten-year low in 2015. Disappointing economically, Ma’s approach was nothing short of disastrous politically: a proposed service trade agreement with China, one of the most important elements in his policy of promoting deeper integration with the mainland, could not be ratified because of mass protest, and then the KMT lost the presidency and control of the Parliament to the DPP in 2016.

To make matters worse, China’s own economic growth has begun to slow as it enters its own middle-income trap, reducing the prospect that China can serve as an engine of growth for Taiwan. This situation has been exacerbated by U.S.-China rivalry: the trade war threatens the profitability of Taiwanese manufacturers in China who export goods to the United States, and the technology war and export controls on sensitive technology have compelled Taiwanese businesses, particularly in the semiconductor industry, to stop taking Chinese orders. After the global financial crisis, Taiwan’s economy recovered gradually and under the DPP since 2016, growth has been higher than in other East Asian high-income economies, yet it has been under 3%. Expectations need to be adjusted to anticipate around the same level of growth for the long term, if not lower when there are crises like the pandemic (Liu 2020). And reliance on China has been slow to drop. Due to rising costs and the trade war, Taiwanese investments in China have declined, but trade has kept growing and in 2018 under President Tsai Taiwan’s trade surplus with China reached nearly \$97 billion – an all-time high.

Economically, Taiwan has been seeking to enhance value-added manufacturing, focusing on the digital economy and software in order to move beyond the lower-end information communications technology industry that has dominated its export economy thus far. However, higher costs, lack of innovation, and increasing competition from emerging markets, including lower-income and middle-income countries, are producing obstacles that seem insurmountable (Liu and Shih 2013). Moreover, in a fully democratic Taiwan, public pressure has mounted for a fairer distribution of economic gains to wider segments of society. While the whole country has become more affluent, inequality has grown as Taiwan has become more integrated into the global value chain because the benefits have gone disproportionately to large corporations and elites (Chi and Kwon 2012; Lee and Lin 2017). More and more people find it a struggle to maintain their standards of living even as a small segment of the population becomes extremely wealthy.

The combination of slower growth, wage stagnation, and growing inequality has a serious political impact on high-income economies.⁶ Several interrelated trends occur when the overall economy becomes less competitive: terms of trade become less favourable, technological change becomes accelerated, enriching a small group of elites rather than the middle class, and economic returns become increasingly skewed towards business owners rather than workers. While other East Asian economies have also seen real wage growth slow since 2000, the gap between economic growth and wage growth has been much greater in Taiwan, as reflected in the declining share of labour compensation as a percentage of GDP (Figure 4.3). After the global financial crisis, Taiwanese workers suffered even more; even though productivity was increasing, real wages did not keep pace and unemployment rose (Huang and Huang 2020). Average real wage levels for Taiwanese in eight out of 19 sectors have been negative since 2000, especially in export-oriented manufacturing. The only sectors where wages grew significantly were related to services, including finance, hospitality, and leisure.

In an effort to sustain growth, governments of high-income Asian economies have resorted to quantitative easing with interest rates kept low for a prolonged period of time – more than two decades in Japan. Elsewhere around the world, low interest rates have also been made possible partly because of low inflation, due largely to cheap imports from China (*The Economist* 2004). After each financial crisis and the 2020 pandemic, it became compelling to keep interest rates low to stimulate the economy, and quantitative easing became the norm. Under competitive pressure, more and more markets adopted such loose monetary policies and no country wanted to be the first to tighten (Shirakawa 2019). But monetary stimulus policies are less effective in high-income societies like those in East Asia with shrinking labour forces, ageing populations, and declining household consumption. Yet as such a policy became prevalent around the world, it produced a vicious cycle where economies do not recover and rates can never be raised. Few

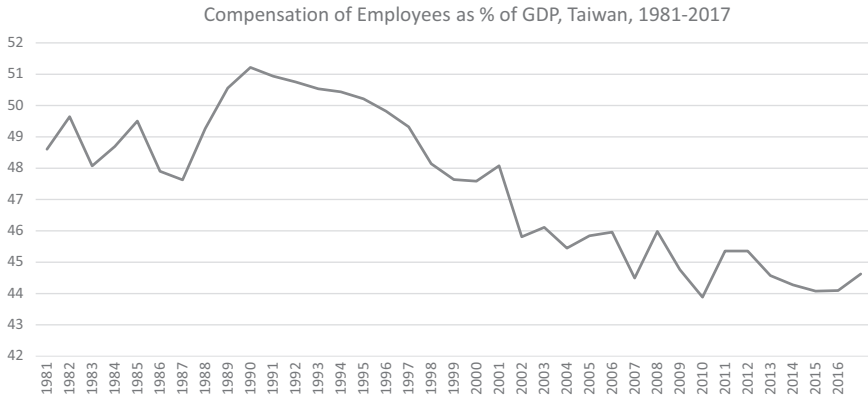


Figure 4.3 Compensation of employees as percentage of GDP, Taiwan, 1981–2017.

Source: DGBAS.

have confidence that change will actually happen because of the entrenched nature of these global financial patterns (Palley 2013).

The unhappy result of low interest rates has been asset inflation and rising levels of household debt. The cost of living in Asian cities has risen markedly, with housing becoming completely unaffordable for young adults, more than a third of whom live with their parents (Chow 2016). Government statistics of 2018 show that in order to purchase a median price apartment in Taipei, one would have to save more than 15 years of income in order to do so without leverage (Figure 4.4). Therefore, families have had to resort to heavy debt in order to purchase a home and household indebtedness as a percentage of GDP has risen to be one of the highest in Asia, exceeding 80% since 2004 (Central Bank of the Republic of China 2019) (Figure 4.5).

The problems produced by low interest rates and accommodative monetary policy are intertwined with the consequences of increasing financialisation, whereby the financial sector has become a more important part of the economy (Davis and Kim 2015). Capital gains through asset appreciation and other forms of unearned income have become more important than earned income, which also benefits large companies and older generations who are asset-rich (Palley 2013). And financial institutions have more influence over the economy compared with the manufacturing industry, thereby creating the ‘Wall Street vs. Main Street’ divide. Global capital flows continue to increase, new financial instruments keep emerging, and regulation tightens in order to rein in the speculators. Paradoxically, market risks and contagion still spread, while global over-regulation has strangled the efficient functioning of financial institutions especially in emerging economies.

The most important implication of asset inflation and financialisation is rising inequality, which is evident in all high-income economies (Lin and

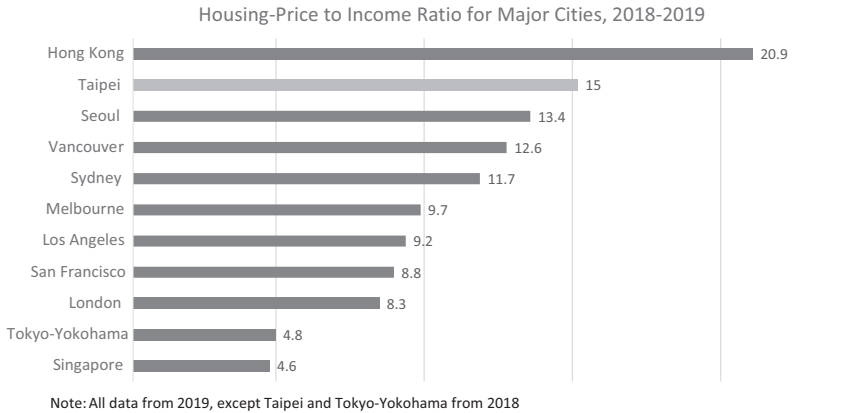


Figure 4.4 Housing price to income ratio for major cities, 2018–19.
 Sources: Data from Ministry of the Interior, Republic of China for Taipei; data from Government of the Republic of Korea for Seoul. Other data from the Demographia International Housing Affordability Survey.

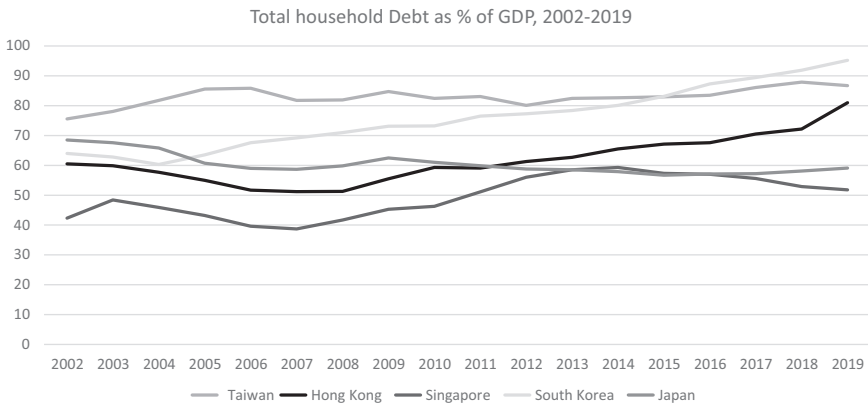


Figure 4.5 Total household debt as percentage of GDP in East Asia, 2002–19.
 Sources: Data for Taiwan from Central Bank, Republic of China; other data from the Bank for International Settlements.

Tomaskovic-Devey 2013). As already noted, the real economic miracle Taiwan experienced during its high-growth decades was not just growth itself, but also the emergence of the middle class and a more equitable society. Today, in contrast, Taiwanese are experiencing unprecedented levels of income and wealth disparity. After integrating more with China economically and socially, Taiwan’s inequality began to rise much more dramatically. Government figures show that the income of the highest 20% of households in

recent years is now six times that of the lowest 20%, compared with only four times in 1976. Although Taiwan's inequality, as measured through its Gini coefficient of 0.338 in 2018, appears more moderate than Hong Kong or Singapore, the financial crises in 2001 and 2009 have worsened the plight of the low-income families which take much longer to recover from economic distress (DGBAS 2019).

Unskilled workers and young people have been most adversely affected by these symptoms of the high-income trap. Youth unemployment has been two to three times the average unemployment rate in Taiwan for the last decade. In 2019, the unemployment rate for ages 15 to 24 was 11.88%, which was three times higher than the average unemployment rate of 3.73%. With poor prospects in terms of jobs and finding affordable housing, young people are getting married later and not having children. This contributes to a demographic decline which is not reversible in the short term and extremely harmful for advanced economies in the long term. The decline in population contributes to lower productivity and consumption: compensating for such declines is difficult even with innovation and technology, which in fact may lead to further job loss and reduced demand.

Like Japan, Hong Kong, Singapore, and South Korea, Taiwan will soon face an absolute decline in population, exceeding the pace of decline in Japan or the United States. Since 2001, Taiwan's fertility has remained at or below 1.3–1.4 children per woman. Taiwan had the lowest fertility rate in the world in 2010 at a mere 0.9 and official projections show that overall population will begin to decline, starting in 2020 (Figure 4.6). Meanwhile, because of an excellent healthcare system, Taiwanese longevity for both men and women continues to improve, putting life expectancy on Taiwan among the top in Asia (Figure 4.7). With lower fertility and improved longevity, by 2026 Taiwan will have become a super-aged nation, defined as societies with over 20% of its population older than 65 years. By 2065, that

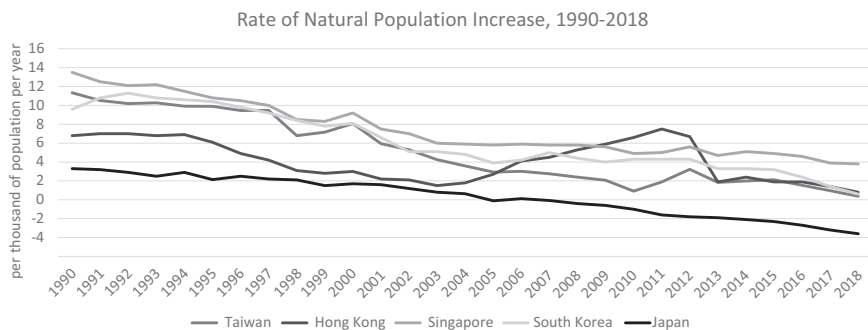


Figure 4.6 Rate of natural population increase in East Asia, 1990–2018.

Sources: Data of Taiwan from DGBAS; the rest from World Development Indicators, World Bank. The rate of natural population increase (RNI) is calculated by subtracting the crude death rate from the crude birth rate.

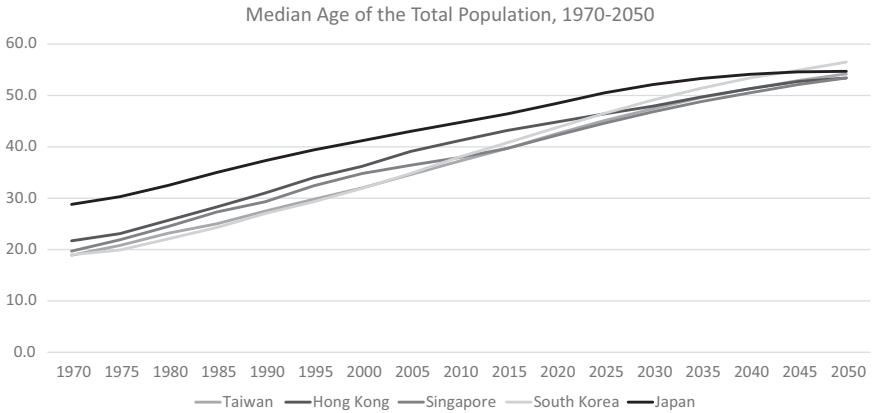


Figure 4.7 Median age of total population in East Asia, 1970–2050.

Source: Population Division, Department of Economic and Social Affairs, United Nations (2019).

percentage will have reached 40% and overall population will have declined by 20%–30% compared with 2018. More importantly, the work force will have declined by half to 8.6 million people, constituting less than half of the total population (Liao 2018). Because of limited immigration, the key to reversing Taiwan’s demographic and productivity decline may lie in having more educated women join the workforce, which in some countries actually leads to higher fertility (Cheng and Loichinger 2017; Loichinger and Cheng 2018). While women are becoming more educated in Taiwan, female labour participation, especially in the private sector, and fertility both remain persistently low. And the government has been slow to adopt a comprehensive set of policy solutions (Cheng and Hsu 2020).

Population decline will not only dampen economic growth, but also place heavy burdens on the welfare and retirement systems, which are expected to become insolvent in a few years for civil servants, military veterans, and retirees (*The Economist* 2017). Similarly, Taiwan’s highly lauded and seemingly affordable single-payer healthcare system may also be unsustainable (Qi 2017). Since Taiwan’s national health programme was overhauled in 1995, analysts have touted it as a model for others. However, with the projected population structure and recent increased spending on curbing COVID-19, the government will have to either cut back on the comprehensiveness of care or increase the share citizens must pay in the future (Scott 2020). This will be accentuated by the pandemic, especially given the high level of service the Taiwan government has delivered.

As a result of these negative economic and demographic developments, entitlements will have to be curtailed, which will entail sacrifices that will be hard for a democracy to accept. Slower growth, stagnating wages, growing

inequality, and reduced benefits will produce political polarisation as more people see themselves as ‘losers.’ Many young and working-class Taiwanese blame global economic integration, especially with China, for Taiwan’s growing inequality and job losses, even as they perceive business elites to have gained tremendously since China opened its economy to Taiwanese investments.

The second half of the double bind: the emergence of a Taiwanese national identity

At the same time that Taiwan struggles with the high-income trap, consensus has been building on a distinct Taiwanese identity, in terms of both preferred national status and self-identification. This process has been underway for decades, despite first the KMT’s use of national education and later Beijing’s use of carrots and sticks to encourage the restoration and maintenance of a Chinese identity (Lin 2016). Since polling on the subject began more than two decades ago, support for immediate unification has never been more than in the low single digits, and the percentage of people who call themselves exclusively ‘Chinese,’ who are the most likely to support some form of unification, has also been in that same range for more than a decade. The latest polls show 87% in favour of autonomy, with only 5.1% favouring ‘maintain status quo, move toward unification’ and a mere 0.7% – an all-time low – favouring ‘immediate unification.’⁷ In terms of self-identification, respondents who identify as exclusively Taiwanese reached a new high at 67%, compared with a new low of 2.4% for those who say they are exclusively Chinese.⁸

Furthermore, the backlash against globalisation or economic liberalisation has been specifically directed at economic integration with China. In 2014, the largest student-led protest in Taiwan’s history, the Sunflower Movement, succeeded in blocking a service trade agreement that would have promoted greater cross-Strait economic integration, but was perceived as leading to more inequality and benefiting mainly the elites. That agreement aroused anger and opposition because of the risk that it would allow massive Chinese investments to dominate many industries in Taiwan that consist primarily of small and medium businesses, including printers, hotels and hair salons. The agreement would also potentially have permitted the migration of Chinese managers and workers to staff those investments, possibly worsening the plight of Taiwanese workers by eliminating jobs and suppressing wages. But beyond these economic grievances, some also saw the prospect of immigration from the mainland as threatening Taiwanese values and paving the way for unification (Ho 2019). To many, the proposed agreement was the epitome of KMT’s policy to open the economic gate to China at the expense of Taiwan’s working class and younger generations.

A few months after the protest, the KMT suffered a great loss in the November 2014 local elections. The DPP won 13 out of 22 contested seats,

and an independent candidate, Ko Wen-je, defeated the KMT contender to win the Taipei mayoral election. Two years later, in the 2016 national elections, the DPP gained control of both the executive and legislative branches for the first time in history. The party's presidential candidate, Tsai Ing-wen, became the first woman head of state or government in Asia who did not come from a political legacy family. A new political party, the New Power Party, elected five first-time legislators, all of whom were associated with the Sunflower Movement and embodied progressive political views and a strong Taiwanese identity. After a turbulent first term, in her second bid for presidency in January 2020 President Tsai won 8.17 million votes, the largest number ever received by any Taiwanese presidential candidate, and the DPP retained its majority in the legislature in a landslide victory. Another new party formed by Taipei Mayor Ko Wen-je, the Taiwan People's Party, won five seats as well. A younger generation, all born on Taiwan and raised in the shadow of China, was a driving force in these electoral changes. They did not believe that President Ma's proposed solution of deeper economic ties with China would create the kind of growth they desired for Taiwan: equitable, sustainable, and not dependent on China. For the youngest Taiwanese, the sense of national identity is very different from their elders. They are overwhelmingly Taiwanese with few if any identifying as Chinese, and they want to retain the way of life associated with living in a prosperous and democratic country. Moreover, many of them assert their distinctive social, economic, and political identities in ways that differentiate them from young people in China, as well as from their parents at home (Lin 2019a). Economically, they question the need to prioritise growth over equity and sustainability. Socially, they want Taiwan to become inclusive and support same-sex marriages. Politically, they mistrust existing institutions and political parties, and are generally less loyal to the major parties, compared with older generations. Furthermore, they care more about Taiwan being respected and recognised internationally and less about how it might challenge the so-called 'status quo.'

They can be called 'pragmatic idealists,' in that they remain motivated by economic opportunities and want to have the option of working or studying in China, but do not want to move to China permanently and insist on safeguarding Taiwan's democratic way of life. They are eager for Taiwan to compete in the Olympics, participate in international organisations such as the World Health Organization, and change even established brands such as 'China Airlines' to something with 'Taiwan' in the name (Chang and Holt 2014). Their support of Taiwan's legalisation of same-sex marriage – the first Asian country to do so – reflects their view that Taiwanese identity should be inclusive and pluralistic, distinct from a Chinese identity which is increasingly ethnic and state-monopolised. Indeed, when legalising same-sex marriage, Taiwan's leaders, in the judiciary, executive, and legislative branches, were responding to eager young voters who demanded that President Tsai fulfil her campaign promise.⁹ While older generations remain focused on

economic prosperity and have strong ideological views on China, young people prefer candidates who are firmly Taiwanese with strong commitment to progressive values, but are result-oriented in governance, and pragmatic about cross-Strait relations. Even if China is not their top choice as a place to live and work, they want to have the choice just like young people anywhere else. Politically, the experience of living and studying in China has not made them more supportive of unification, and in some cases, they have actually become more opposed to it (Lu 2018). To younger generations, there is no contradiction in working in China but supporting a more autonomous and separate Taiwan. Many of them simply regard China as another foreign country that presents a complex blend of opportunity and threat to their homeland.

As Taiwan forged this consensus over national identity, extreme versions of cross-Strait economic policy, such as extensive restriction or full liberalisation, faded from election campaigns. And as Taiwanese identity consolidated, its salience also declined from being a consideration that was explicitly present in every political debate to becoming a shared value that can normally be taken for granted but must be defended when threatened externally (Lin 2016). In recent elections, Taiwanese have rejected leaders whose cross-Strait economic policies they perceived as allowing the mainland to threaten or undermine Taiwan's identity and values. Although not wanting to be excluded from opportunities in mainland China, more voters now support the diversification of Taiwan's economy away from China as espoused by the DPP, especially under the current intense competition between the United States and China.

DPP's response to the double bind

As soon as Tsai was elected in 2016, she began to adopt new approaches to Taiwan's high-income trap that would also show her desire to protect Taiwan's consolidated identity. Tsai's inaugural speech listed the economic challenges facing Taiwan and announced several initiatives to find other sources of economic growth. The most notable was the launch of the New Southbound Policy (NSP), aimed at diversifying Taiwan's trade and investment away from China and towards ASEAN and ten other countries in South Asia and Australasia. With a combined population exceeding two billion, these countries already constituted nearly a fifth of Taiwan's trade and outbound investment (Marston and Bush 2018). Furthermore, in recent years, many *Taishang* (Taiwanese businesses in mainland China), as well as Chinese and foreign companies, have already moved from increasingly costly coastal cities in China to inland cities or to New Southbound countries where costs are lower and growth potential is higher. The NSP was intended to encourage this trend by upgrading Taiwan's economic and political relations with these countries even in the absence of diplomatic ties. The policy differs from Lee Teng-hui's earlier 'go south'

policy in 1994 in that it emphasises comprehensive relations with New Southbound countries, including not only economic ties but also public diplomacy programmes, student exchanges, and economic and technical assistance on issues where Taiwan can offer best practices, from democratic governance, public health, to women's empowerment. The policy also promotes the social integration of immigrants from these countries, although still largely limited to foreign brides (Glaser et al. 2018). While migrant workers and domestic helpers and white-collar professionals are being encouraged to work temporarily in Taiwan, there is no comprehensive immigration scheme to provide permanent residence or fully absorb them into Taiwanese society.

During the first three years of implementation, NSP has shown some notable results contributing to Taiwan's steady growth including record exports. Flows of tourists from New Southbound countries grew by 57%, which contributed to an increase in Taiwan's total tourist arrivals despite a decline in the number of Chinese tourists. Two-way trade and investments increased substantially in the first two years but have levelled off, partly due to closing off during COVID-19. Taiwan's NSP will be further enhanced by the Free and Open Indo-Pacific strategy adopted by the United States and Japan, which is expected to create more opportunities for cooperation and collaboration within the region (United States Department of Defense 2019). Overall, diversification has been driven not only by Tsai's policy, but also because of the U.S.-China rivalry, which has compelled key elements in the global supply chain to diversify away from China.

The NSP was originally viewed in tandem with other avenues for diversifying Taiwan's international economic relationships. One of these was to gain membership in the Trans-Pacific Partnership (TPP). Originally intended as a highly demanding, 'gold standard' free trade agreement linking 12 economies in the Asia-Pacific Region, negotiating the TPP was one of the biggest diplomatic accomplishments of the Obama administration and part of its 'pivot' or 'rebalancing' to Asia. Taiwan was not included among the original 12 signatories and meeting the stringent requirements and overcoming Beijing's almost certain objections to its membership would have been extremely difficult. However, Taipei still hoped to be included in a future round of negotiations when additional economies could be invited to join (Bush 2014). This avenue was dealt a major blow when the Trump administration withdrew from the TPP, as part of its general scepticism about free trade agreements. The successor agreement, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which the remaining 11 economies have agreed to join, continues to offer Taiwan some hope. But Taiwan must convince all 11 remaining signatories, now led by Japan, to include Taiwan in future rounds and then to admit it to membership. Taiwan will have particular difficulties negotiating trade agreements with Japan because of Taiwan's restrictions on imports of Japanese food from five prefectures affected by the Fukushima nuclear leak. China will almost

certainly try to block Taiwan's accession unless Taipei endorses the 1992 Consensus and China is able to join at the same time.

Taiwan may have a better chance of forging a separate bilateral free trade and investment agreement with the United States, given the growing sympathies in Washington for upgrading ties with Taiwan as the American relationship with Beijing deteriorates. But again, Taiwan's restrictions on imported beef and pork from the United States have impeded trade negotiations for years (Taiwan News 2019). Given the high price that some sectors of the Taiwanese economy would have to pay to meet Washington's conditions and the lack of resolve on the part of USTR to meet Taiwan half-way, the prospects for success are still dim.

In addition to these efforts to find new economic partners, Tsai has also implemented long-needed domestic reforms in order to get Taiwan out of the high-income trap. To ease the welfare burden on future generations, Tsai used much of her political capital in her first term to push through a pension reform that would reduce the payout to retired military service members, civil servants, and teachers. According to official forecasts, the pension fund for veterans and public school teachers will default by 2030, unless it is restructured (Chang 2016). Opposition to the reform was much greater than imagined and contributed to the DPP's loss in the 2018 local elections.

Taking pride in being a champion of labour rights, the DPP also rolled out a package of labour reforms that were intended to introduce a five-day workweek, limit working hours, and raise the minimum wage. But because of lack of consultation with relevant stakeholders and haphazard execution, the initial reforms were poorly designed and had to be revised soon after to appease businesses (Snyder and Lien 2018). The amended version of the reforms provoked even stronger opposition, with demands for a long list of clauses and exemptions that favoured employers. Overall, the reform did not have the effect Tsai intended and dissatisfied both employers and employees. Moreover, the reforms were badly implemented and have been widely seen as a failure. Some labour groups actually believe that the reform may have reversed decades of work to improve workers' rights (Hioe 2017).

Other well-intentioned reforms also led to controversy because the Tsai administration was unable to create a consensus over the trade-offs involved. These included efforts to develop a long-term energy policy that would phase out nuclear power by 2025 and promote environmental sustainability. The controversy led to a referendum in November 2018 that effectively retained nuclear energy rather than end its use. The DPP had campaigned for years under the promise to terminate Taiwan's nuclear programme, which generates nearly a fifth of Taiwan's power, and specifically to stop the operation of the fourth nuclear power plant, especially after the Fukushima crisis. But the proposed phase-out of nuclear power has raised several issues in recent years that cannot be easily resolved. First, Taiwan is a net energy importer and energy security is particularly important. Even though Taiwan has the potential to develop wind and solar energy, complete

reliance on renewable energy is not realistic in the short term, so the only alternative to nuclear power is the greater use of carbon fuels (Freschi 2018). And the side effects of increased carbon emissions, especially air pollution, are unacceptable to businesses, environmentalists, and residents, and continue to ignite intense public disagreement even between local and central government (Chao et al. 2020). Moreover, government budgets are highly constrained, which will only obstruct solutions to the problem.

To escape the high-income trap by enhancing economic competitiveness and promoting higher value-added industries, Tsai also initiated a ‘5+2 Industrial Innovation Plan,’ first to invest in the internet of things, the biomedical industry, green energy technology, smart machinery, and the defence industry, and then in two more sectors that were added later: high-value agriculture and the circular economy. The ‘5+2 Plan’ was complemented by a Forward-Looking Infrastructure Development Programme that focuses on railway projects, water management, urban and rural development, the digital economy, and green energy. All these efforts are expected to create jobs and improve environmental sustainability – important priorities for young people – as well as to accelerate economic growth. But increasingly, these stimuli and restructuring plans sound like propaganda slogans with routine bureaucratic implementation and few concrete results.

Moreover, these government programmes to upgrade the economy and promote innovation must be matched by domestic and foreign investments. In the short term, there has been a significant return of investments from the mainland to Taiwan, driven by the rising costs on the mainland and the risks created by the U.S.-China trade war, and encouraged by a repatriation policy that includes subsidies for loans and favourable tax regime (Ihara 2020). Approvals for incoming investments under the ‘Welcoming Taiwanese Businesses to Return to Invest in Taiwan Action Plan’ have reached one trillion NTD dollars (over US\$33 billion) (InvesTaiwan 2020). However, these are only commitments, some of which have not been funded, and represent only a portion of a cumulative total of over US\$180 billion Taiwanese investments in China.

It is also widely recognised that there are structural constraints to upgrading Taiwan’s economy that neither domestic nor foreign investment alone can remove. Attracting private investment will require further reform in financial regulation and the creation of a larger pool of talent trained to meet market needs. The latter will require several structural reforms starting with overhauling the education system to better prepare young people to contribute to a democratic society and competitive economy. Furthermore, Taiwan must attract more high-quality foreign professionals and immigrants. Tsai has introduced measures to ease restrictions on employing foreign workers but a fuller review of immigration policy is also necessary because it is perhaps the only solution to several of Taiwan’s dire problems, including an ageing population, a declining labour force, and lack of innovation (Chang 2019). However, the influx of temporary migrant workers in factories that

cannot attract Taiwanese workers has already created high levels of opposition. Even though Taiwan has already become a more multi-ethnic society with more than half a million foreign spouses naturalised, government agencies and politicians alike do not see the possibility of introducing large-scale immigration reforms (National Immigration Agency 2018).

Another problem is that Taiwan's financial markets are highly regulated and domestic financial institutions are severely constrained for foreign investors. Relative to other high-income economies, Taiwan has had difficulty attracting foreign investments, especially those from multinational corporations which can upgrade Taiwan's economy with jobs and know-how. Allowing Chinese investment into Taiwan would be an easier alternative solution, but it would be strongly opposed. And it has not been widely discussed since Ma Ying-jeou proposed that Taiwan become an 'Asia Pacific Financial Centre' in 2008 and further liberalised mainland investments in 100 sectors in 2009. The 2010 ECFA was intended to promote a cross-Strait financial industry with a series of Memorandums of Understanding that would have lifted restrictions and liberalised regulations on both sides. The most important of these reforms was to allow direct investment in each other's financial industry, including the banking, insurance, and securities industries. There was even the prospect that Taipei would become an RMB offshore centre (Lin 2013). But all such hopes were dashed when the 2014 service trade agreement, which would have enacted these MOUs and given Taiwanese banks preferential terms to invest in China, was shelved following the 2014 mass protests.

Due to these obstacles, the government's goals of moving Taiwan into the digital economy with more value-added manufacturing and higher-end technology in a financial dynamic environment will take years to achieve. At the same time, an increased tension between the United States and China has been challenging to navigate, especially in terms of economic and security relations between Taiwan and the superpowers.

In terms of economic relations, Taiwanese firms and *Taishang* in China have been concerned about becoming unintended victims of the increased tariffs imposed on Chinese exports, as well as global tariffs across several industries which would hurt Made-in-Taiwan products, too (Horton 2018). In the short term, the initial stage of decoupling of the global supply chain may have benefited Taiwan due to both trade diversion and the reshoring of Taiwan's overseas companies (Tan 2020). However, the U.S.-China rivalry and the softening of global demand for Taiwanese products under COVID-19 will eventually hurt Taiwan given its concentration on the export of information and communications technology industry (Feigenbaum and Smith 2020). This will especially be the case if OEM manufacturers are pressured to move out of China, refuse Chinese orders, and invest in the United States to help onshoring as TSMC has done in an ever-intensifying technology war (Sullivan-Walker 2020). Even with heavy subsidies, the cost of production in the United States is likely to be significantly higher than in Taiwan and China.

In terms of security, even as the United States appears more supportive of Taiwan than ever, Taiwan cannot rely exclusively on American intervention, but needs to spend more on defence to face rising PLA capability and assertiveness just when its fiscal resources are become more constrained. In 2019, Taiwan spent more than \$10 billion in purchasing advanced weapons from the United States, and it is likely to purchase more in the future. Tsai has also initiated an indigenous defence industrial programme to produce Taiwan's own submarines and air fighters and become more self-sufficient (Axe 2020).

KMT's response to the high-income trap

As it tries to escape from the unfamiliar status of being a true opposition party – without control of any branch of the Taiwanese government – the KMT will have to decide how to compete with the DPP in developing solutions to Taiwan's high-income trap. As a political party, the KMT has strong connections with large corporations and local interests alike and has always prided itself with well-educated and experienced leaders who understand the economy. Conversely, although far more supportive of both democratisation and Taiwanisation, the DPP has never campaigned with the economy as its priority, nor have DPP leaders demonstrated superior leadership in economic stewardship. During Tsai's first term, her administration was widely criticised for inexperience and poor judgement in carrying out domestic reforms. Furthermore, because Tsai refused to reconfirm the 1992 Consensus, Beijing ended official cross-Strait dialogue immediately and aggressively courted countries to terminate their diplomatic relations with Taiwan, ending the so-called 'diplomatic truce' that had existed during the Ma administration.¹⁰ Economically, Beijing also began to punish Taiwan by reducing the flow of Chinese tourists, hitting the travel, hotel, and retail sectors hard.¹¹ With Beijing stepping up the pressure, the KMT campaigned heavily on the idea that voting for the DPP was damaging to Taiwan economically and threatened Taiwan's security. The KMT promised that it would restore stability in the Taiwan Strait and bring more prosperity to the Taiwanese people by accommodating Beijing and returning to the 1992 Consensus.

Thus in 2018, after only two years of national governance by the DPP, KMT had a strong comeback in the local elections for mayors. Not only did KMT win in a majority of the cities, but it was able to capture the mayoralty of Kaohsiung, which had been a DPP stronghold for 20 years. Much of what Taiwan's voters had given to the DPP in 2014 and 2016 they took away in 2018. The shocking victory by Han Kuo-yu in Kaohsiung is attributed by most analysts to his pledge to find a way out for the city's distressed economy by working more closely with China. And after 20 years of the DPP at the city's helm and an increasing gap between Taipei and Kaohsiung, Kaohsiung voters decided they wanted a change. There was also disappointment

with Tsai's labour, pension, and energy reforms which, however necessary they may have been, had hurt many local interest groups.

Voters in Kaohsiung were therefore attracted by Han's campaign, which squarely focused on the city's economic problems (Horton 2019). As a second-generation Mainlander from New Taipei City and a KMT outsider, Han did not focus on either national identity or party identification in his campaigning. Instead, his emphasis was on the economy, with the campaign slogan 'Sell goods outside! Welcome people to Kaohsiung! Kaohsiung will prosper greatly!'¹² His platform was to bring Kaohsiung to the world, increase exports, bring in tourists, create more jobs, and make Kaohsiung great again.

Han's strategy of globalising the city's economy undeniably appealed to some voters and restoring relations with China was clearly a particular priority. Han proposed a free economic zone in order to attract more Chinese inbound investments. As soon as Han was elected mayor, in March 2019, he visited Hong Kong, Macao, Shenzhen, and Xiamen, and met with the directors of Beijing's liaison office in both special administrative regions. But with little experience, Han lacked a strategy on how Taiwan could address the double bind of taking advantage of the opportunities China offers without harming its autonomy, democracy, and freedom. Moreover, during Han's short tenure as mayor, he was unable to show immediate results in turning around the city's economic fortune. He was also seen as an opportunist since he essentially abandoned his mayoral responsibilities within six months in order to launch a presidential election campaign. Han not only lost the presidential election in January 2020, but by June, he had been removed from office in Taiwan's first successful mayoral recall (Huang et al. 2020).

For the KMT, the disastrous defeat in the 2020 general elections and Han's recall as Kaohsiung's mayor reflected the rejection of both the idea of unification and the specific "One Country, Two Systems" (OCTS) model under which Hong Kong is governed. However, the voters may not have completely turned away from KMT's policy to accommodate China in order to get Taiwan out of the high-income trap. As the opposition party, the KMT increased its representation in the legislature to 38 seats in 2020. Many KMT veterans believe that Beijing's pressure on Taiwan to accept unification as an eventual goal, and the economic benefits China is dangling in front of the Taiwanese, may eventually persuade them to recognise and accept the inevitable, if not enthusiastically embrace it as a brighter future for Taiwan. Furthermore, many KMT supporters believe the Trump Administration to be unreliable, just as previous U.S. administrations had betrayed Taiwan in the past for the sake of its relationship with China (Copper 2020). This may explain why there was a slight increase in support for unification in 2018, and why the KMT still enjoys solid support among some members of the older generations, especially when the DPP's long-term economic performance and its ability to manage cross-Strait relations remain in doubt.

Going forward, however, the KMT's challenge is not just to retain the support of the elderly, but also how to win over the younger generations. In a 2020 June poll by the Taiwan Public Opinion Foundation, not a single respondent in the age group of 20–24 supported the KMT (Chang 2020). The KMT has begun looking for a way to redefine the 1992 Consensus in order to appeal to young voters, while maintaining the reputation that it can guide with the economy better than the DPP (Drun 2020).

Meanwhile, the DPP will continue to be challenged by economic issues. Although it won in a landslide in 2020, promoting Taiwan's economic recovery from COVID-19 will be difficult. Ironically, Taiwan was shielded from the spread of the virus from China because of Beijing's punitive measures to restrict tourists to Taiwan. With hardly any Chinese tourists in 2020 and its early isolation policy, Taiwanese businesses could continue operating normally relative to other high-income economies undergoing quarantines and lockdowns. However, global demand for Taiwan's exports especially in technology has softened and the economy is projected to contract considerably. The recovery will be further complicated by an intensification of the competition between the United States and China and the decoupling of the supply chain. Thus, the KMT's solution to lean more heavily on China will continue to be relevant, but only if it can persuade voters that it can curry favour with Beijing without sacrificing Taiwan's security.

So the double bind – the choice between promoting the economy and preserving Taiwan's autonomy and identity – remains severe. It has been reflected in Han's meteoric rise and sudden fall, and in the alternating futures of the DPP and the KMT in Taiwanese politics. Even though the pendulum has swung much more in favour of safeguarding Taiwan and its values, it will be challenging for the DPP to find new economic policies that can get Taiwan out of the high-income trap. Taiwanese voters, especially younger ones, care about both sound policy design and effective implementation and can change their minds quickly to enforce accountability. Leaders will face an uphill battle to show that they understand the high-income trap issues and can find novel solutions to address them that will also preserve Taiwanese values and identity.

Xi Jinping's carrot and sticks policy and Taiwan's response

For Beijing, pressuring countries such as South Korea and Australia economically, including reducing tourism, trade, and educational exchanges instead of relying only on diplomacy to show its displeasure on bilateral issues, is expected, but unification with Taiwan is a far more important core interest that demands bigger sticks and sweeter carrots. In the hope of winning the hearts of the Taiwanese people, Beijing has tried to offer positive incentives to selected sectors of Taiwanese society as part of Xi's carrot-and-stick approach to Taiwan. Beijing continues to believe that expanding cross-Strait economic relations can help restore a Chinese identity

and renew interest in unification. Towards this end, Beijing is willing both to invest generously and to use hardline measures even if confronted with international pressure. In 2018, Beijing announced the ‘31 Preferential Measures for Taiwanese Compatriots,’ which provided a variety of commercial, educational, and employment opportunities to young people, businesses, and professionals. National treatment in terms of medical, education, and pension benefits has been extended to Taiwanese and Hong Kong compatriots who have chosen to work on the mainland (Huang 2018). Before the 2020 general elections, Beijing doubled down by adding ‘26 Preferential Measures for Taiwanese Compatriots,’ which allowed Taiwanese companies to participate in infrastructure projects and investments in China. During the pandemic, another ‘11 incentives’ were provided to *Taishang* to help alleviate difficulties created by COVID-19 and to include them as beneficiaries in China’s stimulus plans. In addition to the central government’s incentive schemes, local governments at all levels initiated an even wider range of policies to benefit Taiwanese.

After the KMT’s 2018 election victory, economic rewards such as large import orders for agricultural products were offered to cities that had thrown out the DPP and installed new KMT leaders (Maxon 2018). With attractive offers from Chinese institutions for Taiwanese, there is now a visible brain drain from Taiwan to China among professionals and young graduates who are having a hard time finding suitable employment in Taiwan. By providing those material benefits, the aim was to encourage individuals and businesses to support the KMT and against the DPP in order to shore up support for unification.

But overall, Beijing’s strategy tilted more towards sticks rather than carrots. As China’s military and economic power continues to rise, the resolution of the Taiwan issue on Beijing’s terms has emerged as a top priority and an integral part of Xi Jinping’s ‘Chinese Dream.’ At the 19th Party Congress in 2017, Xi again emphasised Beijing’s insistence on unification and its strong opposition to Taiwan independence (Xi 2017). In 2018, as the constitutional term limits on the state presidency were lifted and Xi became the country’s long-term leader, he reiterated that unification with Taiwan was essential to the ‘rejuvenation of the Chinese nation’ (Xi 2018). Emboldened by KMT’s victory in 2018, Xi further demanded that the 1992 Consensus and the ‘One China’ principle must be the pre-condition for restoring cross-strait relations. Tsai tried to mollify Beijing’s demands by stating that she would honour the Republic of China’s constitution and be guided by the ‘Act Governing Relations between the Peoples of the Taiwan Area and the Mainland Area,’ both of which imply that Taiwan and the mainland are part of the same political entity, but without saying so directly.

In January 2019, dissatisfied with Tsai’s guarded response, a confident Xi stepped up the pressure and urged the people of Taiwan to circumvent their own government and work directly for unification under both the 1992 Consensus and the OCTS framework (Xi 2019). In doing so, however, Xi

demanded unification on terms most Taiwanese found unacceptable and, while stating a preference for peaceful unification, again threatened the use of force if the issue were not resolved by an as yet unspecified deadline, but most likely during his term in office. Xi's assertive approach gave Tsai an unexpected opportunity to demonstrate her resolve to defend Taiwan's autonomy and its way of life. Tsai had resigned from the DPP chairmanship to take responsibility for the party's crushing defeat in the 2018 local elections and was facing increasing pressure in her party not to run for re-election in 2020. But after she forcefully rejected Xi's speech, declaring that Taiwan would never accept OCTS and emphasising that 'democratic values are the values and way of life that Taiwanese cherish,' her popularity rebounded dramatically throughout 2019 (Lin 2019b).

Beginning in June 2019, Hong Kong's mass protests against a controversial extradition law, involving a record number of two million people at one point, only reinforced the view that OCTS is a failure in Hong Kong and is unacceptable to Taiwan. The proposed bill would have facilitated sending accused people from Hong Kong to China to be tried in the Chinese legal system. The fate of the proposed law was seen as an important bellwether of whether China would keep its promise to grant Hong Kong a high degree of autonomy and to tolerate freedom of speech and press (Cheung 2019). Even after Hong Kong's Chief Executive Carrie Lam withdrew the bill in October, the protests did not stop, and there were also international reverberations highlighted by the United States adopting the 'Hong Kong Human Rights and Democracy Act.' The Taiwanese expectation of the worst in Hong Kong was coming true (Mazza 2020). Moreover, the perceived parallels between Hong Kong and Taiwan were growing, with many Taiwanese fearing that 'today's Hong Kong is tomorrow's Taiwan' (Green and Medeiros 2020). This has further boosted Tsai's popularity and made the acceptance of OCTS even more unlikely. Any economic solution to Taiwan's high-income trap that gives a central role to China has therefore become even harder to sell politically.

Furthermore, as the rivalry between the United States and China intensifies, Beijing appears to be more focused on pressuring Taiwan at all costs, perhaps because it believes time is no longer on its side especially in the weeks leading up to Taiwan's 2020 elections. Specifically, Beijing is accelerating its military investments to gain superiority in the Taiwan Strait (Work and Grant 2019). The PLA was consistently conducting drills and exercises near Taiwan, with the *Liaoning* aircraft carrier passing through the Taiwan Strait, ships frequently circumnavigating Taiwan, and aircraft even entering Taiwan's air defence identification zone (Yu and Yeh 2020). Diplomatically, Beijing lured the Solomon Islands and Kiribati to recognise Beijing and cut off ties with Taipei in the fall of 2019. Economically, Beijing further barred individual tourists from 47 cities from going to Taiwan, after first restricting group tourists. For Taiwan to navigate between the two superpowers and continue to engage with China economically while ensuring that the United

States continues to act as Taiwan's security guarantor had become increasingly difficult.

During the COVID-19 pandemic, Beijing has shown how it would only take the opportunity to make Taiwan's position untenable rather than extend an olive branch during a humanitarian crisis. Without any help from China or the WHO, the DPP administration's handling of the pandemic has won praise all around the world. But China then placed more pressure on the World Health Organization to refuse Taiwan's participation even as an observer during this crisis (Rowen 2020). In addition to leveraging hard and sticky power, Beijing has used its sharp power to influence and undermine Taiwan's democratic process through subversive policies. China has been identified to have used social media to influence the outcome of the 2018 local elections, as well as paid media outlets to continue to infiltrate Taiwanese society in the run-up to the 2020 general elections (Schmitt and Mazza 2019). However, the disinformation campaign ironically galvanised the Taiwanese people to combat disinformation and uphold freedom of speech.

Overall, the contradiction between Beijing's positive and negative incentives and the selective nature of the carrots being offered by Beijing and the risks they pose to Taiwan's security have not had the impact on Taiwanese public opinion that Beijing had hoped for. And Hong Kong's unrest has made Taiwanese even more concerned about Chinese influence and less attracted to the concept of unification than ever before. Beijing may eventually come to realise that Taiwanese are likely to continue to take the carrots without changing their minds about unification. This may exacerbate the trend for Beijing to focus more on the sticks and offer fewer carrots.

Conclusion

In her second term, Tsai faced new challenges, such as the COVID-19 pandemic, which posed a serious test for all governments trying to navigate between the two superpowers. However, the challenge ahead in terms of reviving the economy may force Taiwan to accept more dependence on China for its future, especially if the United States like other industrialised economies suffers relatively more than China in the face of the pandemic. The outcome may be similar to how China played a more important role internationally after the global financial crisis of 2009 by assisting both Western and developing countries in their recovery (Breslin 2012). If China gains an advantage relative to the United States and Europe after the COVID-19 crisis, it could become more assertive in changing the international norms and marginalising Taiwan. Many pundits see Tsai and the DPP as playing with fire by leaning excessively on the United States given how inconsistent Donald Trump's policies towards China have been. The implications for Taiwan of any missteps in this regard will be severe.

Cross-Strait relations have always played a greater role in presidential contests than in local elections, but discussions of the issue will remain

within the new context of finding the most effective way of escaping the high-income trap while preserving the autonomy that the overwhelming majority of Taiwanese want. Taiwanese voters' main concern is to find a way out of Taiwan's high-income trap without diluting their identity and fundamental values, including democracy, political autonomy, social justice, and environmental sustainability. The salience of identity, however, has increased dramatically as Beijing intensifies pressure on unification. It has become *de rigueur* for leaders to stand firm against Chinese intimidation in 2020. Such a development will put more obstacles to further economic integration with China, even if that should be a critically important strategy for escaping the high-income trap especially in the wake of the pandemic.

The double bind makes it difficult for any leader to find solutions to Taiwan's high-income trap that can also maintain Taiwan's autonomy, safeguard its values, and defend Taiwan's distinctive identity. Indeed, all the solutions to the high-income trap involve trade-offs, and it will be difficult to reach an agreement on how to prioritise competing goals and reach agreement on the best policies to achieve them. Leaders will find it difficult to mitigate the losses suffered by specific groups in the process of rebalancing Taiwan's economy, protecting its environment, and restructuring Taiwan's society, even though economic reforms are urgently needed.

In the end, the high-income trap may not have solutions that are effective, let alone easy. It may be impossible for high-income economies to grow at a steady rate and achieve rising standards of living. Rapid growth may be impossible as citizens demand greater fairness and more environmental sustainability. Small trading countries like Taiwan also face the issue of continuing competition from seemingly inexhaustible sources of cheaper goods and services, especially from a trading partner like China that is a strategic threat. With fewer resources than in the past, countries like Taiwan will find it extraordinarily difficult to adapt to slower growth and re-prioritise economic goals according to the demands of younger generations.

Notes

- 1 World Bank resets the threshold for 'high-income economies' each year based on gross national income, which is \$12,376 or more in 2020.
- 2 Most high-income economies are democracies. For a discussion of the correlation and how economic development is conducive to democracy, see Inglehart and Welzel, 2009. For Taiwan, most academic theories do not sufficiently show whether there is causality or correlation; see Wu, 2020.
- 3 The 13 economies are Equatorial Guinea, Greece, Hong Kong, Ireland, Israel, Japan, Mauritius, Portugal, Puerto Rico, the Republic of Korea, Singapore, Spain, and Taiwan.
- 4 Argentina has reached the high-income status twice but remains in the middle-income status.
- 5 Compare this with IMF's 2020 forecast for South Korea at -1.2%, Singapore -3.5%, Hong Kong -4.8%, and Japan -5.2%. See World Economic Outlook Database (April 2020 Edition).

- 6 Such negative distributional consequences of globalisation on high-income economies can be seen in the United States where wages have stagnated since 2000.
- 7 'Autonomy' here includes categories 'Maintain status quo, decide at later date,' 'Maintain status quo indefinitely,' 'Maintain status, quo, move toward independence,' and 'Independence as soon as possible.'
- 8 Another 27.5% of the respondents identify themselves as 'both Taiwanese and Chinese.' See ESC 2020.
- 9 For example, 80% of young people support same-sex marriage. See Jennings (2016).
- 10 China has convinced seven countries to sever diplomatic ties with Taiwan since the DPP returned to power in 2016.
- 11 In 2019, 2.7 million Chinese tourists visited Taiwan, compared with 4.18 million in 2015, as per Tourism Statistics Database (2020).
- 12 Han's Chinese slogan was 'Export products, welcome people in, make Kaohsiung rich' (貨出得去、人進得來, 高雄發大財).

References

- Axe, David. 2020. 'Here's How Taiwan Could Still Build Its Own Submarines,' *National Interest*, January 9, 2020, at <https://nationalinterest.org/blog/buzz/heres-how-taiwan-could-still-build-its-own-submarines-112156>.
- Breslin, Shaun. 2012. 'Paradigm(s) Shifting? Responding to China's Response to the Global Financial Crisis.' In Wyn Grant and Graham K. Wilson (eds.), *The Consequences of the Global Financial Crisis: The Rhetoric of Reform and Regulation*. London: Oxford University Press, 226–246.
- Bush, Richard C. 2014. 'Taiwan and the Trans-Pacific Partnership: The Political Dimension,' Brookings Institute, February 11, 2014, at <https://www.brookings.edu/research/taiwan-and-the-trans-pacific-partnership-the-political-dimension/>.
- Central Bank of the Republic of China. 2019. 'Financial Stability Report No. 13,' May 2019, at <https://www.cbc.gov.tw/en/cp-970-101274-78a63-2.html>.
- Chang, Huey-por. 2020. 'KMT Lacks Message Appealing to Young Voters,' *Taipei Times*, July 5, 2020, at <https://www.taipeitimes.com/News/editorials/archives/2020/07/05/2003739368>.
- Chang, Hui-ching and Richard Holt. 2014. *Language, Politics and Identity in Taiwan: Naming China*. London: Routledge.
- Chang, Jennifer I-wei. 2019. 'Implications of Taiwan's Demographic Decline,' *Global Taiwan Brief* 4, no. 20, at <http://globaltaiwan.org/2019/10/vol-4-issue-20/>.
- Chang, Meg. 2016. 'A Necessary Reform,' *Taiwan Today*, September 1, 2016, at <https://taiwantoday.tw/news.php?unit=29&post=102493&unitname=&postname=A-Necessary-Reform>.
- Chao, Li-yan, Su Mu-chun and Matthew Mazzetta. 2020. 'Taichung Government, Taipower Clash over Coal-Powered Generator,' *Focus Taiwan*, June 26, 2020, at <https://focustaiwan.tw/society/202006260005>.
- Cheng, Yen-hsin Alice and Elke Loichinger. 2017. 'The Future Labor Force of an Aging Taiwan: The Importance of Education and Female Labor Supply,' *Population Research and Policy Review* 36, no. 3, 441–66.
- Cheng, Yen-hsin Alice and Hsu Chen-hao. 2020. 'No More Babies without Help for Whom? Education, Division of Labor, and Fertility Intentions,' *Journal of Marriage and Family* 82, 1270–85.

- Chi, Eunju and Hyeok Yong Kwon. 2012. 'Unequal New Democracies in East Asia: Rising Inequality and Government Responses in South Korea and Taiwan.' *Asian Survey* 52, no. 5, 900–23.
- Chow, Jermyn. 2016. 'A Third of Taiwan's Adults Still Live with Mum and Dad,' *Strait Times*, September 13, 2016, at <https://www.straitstimes.com/asia/east-asia/a-third-of-taiwans-adults-still-live-with-mum-and-dad>.
- Copper, John F. 2020. 'Taiwan's 2020 Presidential, Vice Presidential and Legislative Election: Testing Election Theories.' *East Asian Policy* 12, no. 2, 45–56.
- Davis, Gerald F. and Kim Suntae. 2015. 'Financialization of the Economy.' *Annual Review of Sociology* 41, 203–21.
- DGBAS. 2019. 'Report on the Survey of Family Income and Expenditure, 2018,' October 2019, at <https://win.dgbas.gov.tw/fies/doc/result/107.pdf>.
- Drun, Jessica. 2020. 'Taiwan's Opposition Struggles to Shake Pro-China Image,' *Foreign Affairs*, March 11, 2020, at <https://foreignpolicy.com/2020/03/11/taiwan-opposition-kuomintang-kmt-pro-china-1992-consensus/>.
- ESC. 2020. 'Trends of Core Political Attitudes (1992/06~2020/6),' Election Study Center (ESC), National Chengchi University, at <https://esc.nccu.edu.tw/course/news.php?class=203>.
- Feigenbaum, Evan A. and Jeremy Smith. 2020. 'Taiwan Was Having a Terrific US-China War Until Coronavirus Arrived,' *National Interest*, April 28, 2020, at <https://nationalinterest.org/blog/buzz/taiwan-was-having-terrific-us-china-trade-war-until-coronavirus-arrived-149101>.
- Freschi, Nicolas. 2018. 'Taiwan's Nuclear Dilemma,' *The Diplomat*, March 14, 2018, at <https://thediplomat.com/2018/03/taiwans-nuclear-dilemma/>.
- Glaser, Bonnie S., Derek Mitchell, Scott Kennedy and Matthew P. Funairole. 2018. 'The New Southbound Policy: Deepening Taiwan's Regional Integration,' Center for Strategic & International Studies, January 19, 2018, at <https://www.csis.org/analysis/new-southbound-policy>.
- Green, Michael and Evan Medeiros. 2020. 'Is Taiwan the Next Hong Kong? Hioe, Brian. 2017. 'Tsai Administration's Planned Labor Reforms Disastrous,' *New Bloom Magazine*, November 8, 2017, at <https://newbloommag.net/2017/11/08/tsai-labor-reforms-2017/>.
- Ho, Ming-sho. 2019. *Challenging Beijing's Mandate of Heaven: Taiwan's Sunflower Movement and Hong Kong's Umbrella Movement*. Philadelphia: Temple University Press.
- Horton, Chris. 2018. 'Trade War Traps Taiwan between Two Superpowers,' *Nikkei Asian Review*, December 5, 2018, at <https://asia.nikkei.com/Spotlight/Cover-Story/Trade-war-traps-Taiwan-between-two-superpowers>.
- Horton, Chris. 2019. 'Candidate Seeks Closer China Ties, Shaking Up Taiwan's Presidential Race,' *New York Times*, June 6, 2019, at <https://www.nytimes.com/2019/06/06/world/asia/taiwan-han-president.html>.
- Huang, Kristin. 2018. 'Taiwanese Given 'Equal Status' on China's Mainland, but Is Beijing Just Trying to Buy Their Support?' *South China Morning Post*, March 1, 2018, at <https://www.scmp.com/news/china/policies-politics/article/2135291/taiwanese-given-equal-status-chinas-mainland-beijing>.
- Huang, Li-hsuan, and Huang Hsin-yi. 2020. 'Real Wage Stagnancy: Evidence from Taiwan.' *The Singapore Economic Review* 65, no. 2, 485–506.
- Huang, Hsin-po, Hung Chen-hung, Hsu Li-chuan and Jake Chung. 2020. 'Kao-hsiung Voters Recall Han Kuo-yu,' *Taipei Times*, June 7, 2020, at <https://www.taipeitimes.com/News/front/archives/2020/06/07/2003737773>.

- Ihara, Kensaku. 2020. 'Taiwan Tech Companies' Exit from China Fuels \$25bn Investment Drive,' *Financial Times*, June 11, 2020, at <https://www.ft.com/content/1389cc16-bf2f-4fcd-8976-86334fc506d4>.
- Inglehart, Ronald and Christian Welzel. 2009. 'How Development Leads to Democracy: What We Know about Modernization,' *Foreign Affairs* 88, no. 2, 33–48.
- InvesTaiwan, Ministry of Economic Affairs, R. O. C. (Taiwan). 2020. 'Three Major Programs for Investing in Taiwan,' at <https://investtaiwan.nat.gov.tw/showPagecht1135?lang=eng&search=1135&menuNum=58>.
- Jennings, Ralph. 2016. 'Taiwan Set to Legalize Same-Sex Marriages, a First in Asia,' Associated Press, November 11, 2016, at <https://apnews.com/e9c5b9c82abe4bc987f820aa104f2893>.
- Lee, Zong-rong and Thung-hong Lin, eds. 2017. *Unfinished Miracle: Taiwan's Economy and Society in Transition*. Taipei: Academia Sinica, Institute of Sociology.
- Liao, George. 2018. 'MOI: Taiwan Officially Becomes an Aged Society with People over 65 Years Old Breaking the 14-Percent Mark,' *Taiwan News*, 10 April 2018, at <https://www.taiwannews.com.tw/en/news/3402395>.
- Lin, Ken-hou and Donald Tomaskovic-Devey. 2013. 'Financialization and U.S. Income Inequality, 1970–2008,' *American Journal of Sociology* 118, no. 5, 1284–329.
- Lin, Liang-sheng and Jake Chung. 2018. 'Ma Backs "Consensus" to Mark Xi Meeting,' *Taipei Times*, November 8, 2018, at <http://www.taipetimes.com/News/taiwan/archives/2018/11/08/2003703822>.
- Lin, Syaru Shirley. 2013. 'Taiwan and the Advent of a Cross-Strait Financial Industry,' Paper prepared for the Conference on Taiwan Inclusive: Trends, Opportunities and Challenges, the Miller Center, University of Virginia, November 15–16, 2013, at <http://www.shirleylin.net/publicationsblog/2016/7/22/taiwan-and-the-advent-of-a-cross-strait-financial-industry>.
- Lin, Syaru Shirley. 2016. *Taiwan's China Dilemma: Contested Identities and Multiple Interests in Taiwan's Cross-Strait Economic Policy*. Stanford: Stanford University Press.
- Lin, Syaru Shirley. 2019a. 'Analyzing the Relationship between Identity and Democratization in Taiwan and Hong Kong in the Shadow of China,' *The ASAN Forum*, December 20, 2019, at <http://www.theasanforum.org/analyzing-the-relationship-between-identity-and-democratization-in-taiwan-and-hong-kong-in-the-shadow-of-china/>.
- Lin, Syaru Shirley. 2019b. 'Xi Jinping's Taiwan Policy and Its Impact on Cross-Strait Relations,' *China Leadership Monitor*, June 1, 2019, at [https://www.prcleader.org/lin.Liu, Da-Nien and Shih Hui-Tzu. 2013. 'The Transformation of Taiwan's Status within the Production and Supply Chain in Asia,' Brookings Institute, December 4, 2013, at <https://www.brookings.edu/opinions/the-transformation-of-taiwans-status-within-the-production-and-supply-chain-in-asia/>.](https://www.prcleader.org/lin.Liu, Da-Nien and Shih Hui-Tzu. 2013. 'The Transformation of Taiwan's Status within the Production and Supply Chain in Asia,' Brookings Institute, December 4, 2013, at https://www.brookings.edu/opinions/the-transformation-of-taiwans-status-within-the-production-and-supply-chain-in-asia/)
- Liu Shih-chung. 2020. 'Taiwan Faces a Changed Economic Outlook in Asia Following COVID-19,' Brookings Institution, June 29, 2020, at <https://www.brookings.edu/blog/order-from-chaos/2020/06/29/taiwan-faces-a-changed-economic-outlook-in-asia-following-covid-19/>.
- Cheung, Anthony B.L. 2019. 'What has gone wrong in Hong Kong?,' *Public Administration and Policy: An Asia-Pacific Journal* 22, no. 2, 93–96.
- Loichinger, Elke and Yen-hsin Alice Cheng. 2018. 'Feminising the Workforce in Ageing East Asia? The Potential of Skilled Female Labour in Four Advanced Economies,' *Journal of Population Research* 35, no. 2, 187–215.
- Lu, Chen-wei. 2018. 'For Taiwanese Youth, Does Studying in China Lead to Changes in Political Identity?' *The Taiwan Gazette*, September 11, 2018, at <https://>

- www.taiwangazette.org/news/2018/10/5/for-taiwanese-students-does-studying-in-china-lead-to-changes-in-political-identity.
- Manyika, James Jonathan Woetzel, Richard Dobbs, Jaana Remes, Eric Labaye, and Andrew Jordan. 2015. 'Can Long-term Global Growth Be Saved?' McKinsey Global Institute, January 2015, at <https://www.mckinsey.com/featured-insights/employment-and-growth/can-long-term-global-growth-be-saved>.
- Marston, Hunter and Richard C. Bush. 2018. 'Taiwan's Engagement with Southeast Asia Is Making Progress under the New Southbound Policy,' Brookings Institution, July 30, 2018, at <https://www.brookings.edu/opinions/taiwans-engagement-with-southeast-asia-is-making-progress-under-the-new-southbound-policy/>.
- Maxon, Ann. 2018. 'Beijing Likely to Target KMT-Held Areas: Academics,' *Taipei Times*, November 27, 2018, at <http://www.taipeitimes.com/News/taiwan/archives/2018/11/27/2003705008>.
- Mazza, Michael. 2020. 'Why the Hong Kong National Security Law Matters for Taiwan,' American Enterprise Institute, July 15, 2020, at <https://www.aei.org/articles/why-the-hong-kong-national-security-law-matters-for-taiwan/>.
- National Immigration Agency. 2018. 'Interview with Director-General Jeffrey Yang of the ROC Immigration Agency,' National Immigration Agency of the Ministry of the Interior, R. O. C. (Taiwan), January 31, 2018, at <https://www.immigration.gov.tw/5385/7344/7350/8887/?alias=settlementdown>.
- Newsham, Grant. 2020. 'Taiwan's Tightwad Defense Spending an Expensive Risk,' *Asia Times*, July 17, 2020, at <https://asiatimes.com/2020/07/taiwans-tightwad-defense-spending-a-rising-risk/>.
- Ostry, Jonathan David, Andrew Berg, and Charalambos G. Tsangarides. 2014. 'Redistribution, Inequality and Growth,' *IMF Staff Discussion Note*, no. 14/02, at <https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2016/12/31/Redistribution-Inequality-and-Growth-41291>.
- Palley, Thomas. 2013. *Financialization*. London: Palgrave Macmillan.
- Qi, Dongtao. 2017. 'Social Welfare Expansion and National Health Insurance in Taiwan.' In Dongtao Qi and Lijun Yang (eds.), *Social Development and Social Policy: International Experiences and China's Reform*. Singapore: World Scientific Publishing, 199–231.
- Rowen, Ian. 2020. 'Crafting the Taiwan Model for COVID-19: An Exceptional State in Pandemic Territory,' *The Asia-Pacific Journal* 18, no. 14, at <https://apjff.org/2020/14/Rowen.html>.
- Schmitt, Gary and Michael Mazza. 2019. 'Blinding the Enemy: CCP Interference in Taiwan's Democracy,' Global Taiwan Institute, October 2019, <http://globaltaiwan.org/wp-content/uploads/2019/10/GTI-CCP-Interference-Taiwan-Democracy-Oct-2019-final.pdf>.
- Scott, Dylan. 2020. 'Taiwan's Single-Payer Success Story — And Its Lessons for America,' *Vox*, January 13, 2020, at <https://www.vox.com/health-care/2020/1/13/21028702/medicare-for-all-taiwan-health-insurance>.
- Shirakawa, Masaaki. 2019. "The Mirage of Interest Rate Normalization," *Nikkei Asian Review*, April 10, 2019, at <https://asia.nikkei.com/Opinion/The-mirage-of-interest-rate-normalization>.
- Snyder, Nathan and Jeffrey Lien. 2018. 'Taiwan's Latest Labor Standards Act Amendments,' *Taiwan Business TOPICS*, March 6, 2018, at <https://topics.amcham.com.tw/2018/03/taiwans-latest-labor-standards-act-amendments/>.

- Sullivan-Walker, Kate. 2020. 'The Semiconductor Industry Is Where Politics Gets Real for Taiwan,' Lowy Institute, July 9, 2020, at <https://www.lowyinstitute.org/the-interpreter/semiconductor-industry-where-politics-gets-real-taiwan>.
- Taiwan News. 2019. 'Taiwan's Ban on American Beef, Pork a Trade Barrier: US Report,' March 30, 2019, at <https://www.taiwannews.com.tw/en/news/3669693>.
- Taiwan Tourism Bureau. 2020. 'Tourism Statistics Database.' 2020, at <https://stat.taiwan.net.tw/>.
- Tan, Huileng. 2020. 'Taiwan's Economy Has Held Up "Extremely Well" Despite the Coronavirus, Says Economist,' CNBC, June 29, 2020, at <https://www.cnbc.com/2020/06/29/taiwans-economy-has-held-up-extremely-well-despite-the-coronavirus.html>.
- The Economist*. 2004. 'Unnaturally Low,' October 2, 2004, at https://www.economist.com/special-report/2004/10/02/unnaturally-dlow?FEATURE_ARTICLES_V1=0.
- The Economist*. 2017. 'Taking on Taiwan's Ruinous and Partisan Pension System,' May 18, 2017, at <https://www.economist.com/asia/2017/05/18/taking-on-taiwans-ruinous-and-partisan-pension-system>.
- United States Department of Defense. 2019. 'Indo-Pacific Strategy Report,' June 1, 2019, <https://media.defense.gov/2019/Jul/01/2002152311/-1/-1/1/DEPARTMENT-OF-DEFENSE-INDO-PACIFIC-STRATEGY-REPORT-2019.PDF>.
- Work, Robert O. and Greg Grant. 2019. 'Beating the Americans at Their Own Game,' Center for a New American Security, June 6, 2019, at <https://www.cnas.org/publications/reports/ beating-the-americans-at-their-own-game>.
- World Economic Outlook Database (April 2020 Edition), at <https://www.imf.org/external/pubs/ft/weo/2020/01/weodata/index.aspx>.
- Wu, Nai-teh (吳乃德). 2020, 《臺灣最好的時刻, 1977–1987: 民族記憶美麗島》, 台灣: 春山出版.
- Xi, Jinping. 2017. 'Report at the 19th National Congress of the Communist Party of China,' full text available at *China Daily*, October 18, 2017, at http://www.chinadaily.com.cn/china/19thcpnationalcongress/2017-11/04/content_34115212.htm.
- Xi, Jinping. 2018. 'Speech Delivered by Xi Jinping at the First Session of the 13th NPC,' *China Daily*, March 21, 2018, at <https://www.chinadailyhk.com/articles/184/187/127/1521628772832.html>.
- Xi, Jinping. 2019. 'Working Together to Realize Rejuvenation of the Chinese Nation and Advance China's Peaceful Reunification: Speech at the Meeting Marking the 40th Anniversary of the Issuance of the Message to Compatriots in Taiwan,' Taiwan Affairs Office of the State Council, the People's Republic of China, January 2, 2019, at http://www.gwytb.gov.cn/wyly/201904/t20190412_12155687.htm.
- Yu, Matt and Joseph Yeh. 2020. 'Chinese Military Planes Enter Taiwan's ADIZ for 8th Time in June,' *Focus Taiwan*, June 22, 2020, at <https://focustaiwan.tw/cross-strait/202006220018>.