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# CHINA HORIZONS

DEALING WITH A RESURGENT CHINA

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## The Taiwanese Economy after the Elections: Takeaways for the European Union



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## Abstract

The results of Taiwan's elections have confirmed that the ruling party, the Democratic and Progressive Party (DPP) remains the preferred option of voters, but with more checks and balances than during the past eight years, with the DPP losing control of Taiwan's legislative body. This implies that compromises will need to be reached, including on economic policies. Choices over the direction of the Taiwanese economy will need more consensus than before, including on the question of further economic diversification away from Mainland China, towards the US and the rest of Asia. The EU has not yet benefitted as much as the US, Japan or Southeast Asia from Taiwan's diversification, neither in terms of exports nor in terms of attracting foreign direct investment (FDI) from Taiwan. Given Taiwan's increasing importance as a foreign investor in high-end technology, the EU has an opportunity to strengthen its economic ties with Taiwan after the elections but the tool to do so will hardly be a trade or investment treaty since not even closer allies, such as the US or Japan, have finalized their trade/investment negotiations. The most obvious leverage for the EU is its position as largest foreign direct investor in Taiwan.

## Key Findings

- After winning the presidency of Taiwan for the third time last January 13<sup>th</sup>, the Democratic and Progressive Party (DPP) has realized how much more difficult this term will be compared to the previous ones. This is because the long-ruling and pro-China party, the Kuomintang (KMT) not only managed to obtain more seats at the legislative body, the "Yuan", but even managed to appoint the speaker last February 1. The DPP will, thus, be much more constrained on its policies, which is good news in terms of reduced geopolitical risk. However, the difficult legislative process brings more uncertainty about the direction of policies in Taiwan, including economic ones.
- Tailwinds for the incoming government comes from the economic outlook for 2024, which foresees GDP growth more than doubling. This will be driven mainly by a much more positive cycle for the electronics and semiconductor sectors.
- One key economic policy pursued under the DPP's administration for the last eight years has been the geographical diversification of trade and investment away from Mainland China and towards the rest of Asia and the United States. It is unclear whether the diversification push will continue with a more constrained DPP. This is important for the EU since it has so far very much missed the boat of attracting Taiwanese foreign direct investment into Europe. Taiwan's growing role in advanced technology, in particular in advanced semiconductors, makes this endeavor particularly important for Europe even if it is highly unlikely that the EU can negotiate a trade/investment agreement with Taiwan since not even its most obvious allies have finalized theirs nor has Taiwan been able to start negotiations to become member of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) after applying in 2021. The EU most important leverage hovers around being the largest foreign direct investor in Taiwan at a time when growing geopolitical tensions are reducing the attractiveness of the island as an FDI destination.

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# 1. Key issues

On 13 January 2024, over 70% of people turned out to vote for the next President of Taiwan and for representatives in the country's parliament, the Legislative Yuan. Lai Ching-te, leader of the liberal Democratic Progressive Party (DPP), won the presidential election. However, his party, already in government for eight years, did not secure enough votes to control the Legislative Yuan. In fact, on February 1, the most crucial position in the legislative yuan, the speaker, went to Taiwan's old ruling party which has closer ties to the mainland, the Kuomintang (KMT), which managed to obtain one seat more than the DPP (52 versus 51), thanks to the votes of two small independent parties. Still, the key for the DPP to be able to legislate lies on the potential support of the third largest party in this election, the Taiwan People's Party (TPP) with 8 seats. Because Taiwan's political system is semi-presidential, the DPP will still appoint the President, but lawmaking will be much harder than it has been for the past eight years.

Against such backdrop, the DPP will need to accept that its powers are now more limited, including how it interacts with mainland China. A softer approach will likely emerge, while the degree of actual cooperation with mainland China will very much depend on the TPP, which did not clarify its stance on this crucial issue during the election campaign. Mainland China has not at time of writing reacted forcefully to the election results, possibly because it is satisfied that the DPP will be more constrained in legislating than previously.

In its electoral campaign, the DPP made it clear that further geographical diversification of the Taiwanese economy away from the mainland is in Taiwan's interest. Geographical diversification has happened faster for Taiwanese outbound foreign direct investment (FDI) than for trade. Taiwan's outbound FDI directed to the mainland decreased from 65% during the KMT's last administration (from 2008-2016) to 35% during the DPP's last two terms under President Tsai Ing-wen. While the government did push for the so-called 'South-Bound Policy,' which was intended to stimulate investment in ASEAN countries and India, the big increase in FDI into Japan, the United States and Germany in relation to semiconductors is likely more market-driven.

In trade, the diversification process began more recently. Exports to the mainland have been very resilient, even during US President Trump's trade war. Trade exports increased in 2020 to more than 40% of total exports. Exports to the mainland have decreased since then and stand at 35% today. How much this diversification process should be seen as a geopolitical move to 'de-risk' trade is as yet unknown. The surge in Taiwan's outbound FDI – through large investments in semiconductor factories in the US, Japan and Germany – could put Taiwan's so-called "silicon shield" at risk. In other words, the fact that Taiwan's advanced semiconductors could soon be produced in the US or Japan could reduce the incentives for the US and other allies to defend Taiwan in the future.

So far, the EU has not benefitted much from Taiwan's trade and investment diversification, at least when compared to the US and the rest of Asia. The lack of a trade or investment deal could be considered important, but some of Taiwan's other trading partners are also in this position of lacking a deal. Considering that the EU is the largest foreign direct investor in Taiwan, the question arises of whether the EU should attempt to foster more bilateral economic

relations. This could include increasing EU exports to Taiwan and taking advantage of outbound Taiwanese FDI in technology.

The problem with such a plan, namely the EU catching up with Japan and the US as recipient of outbound FDI from Taiwan, is that it is coming a bit late, as the DPP will have less control on the economic agenda given the inconclusive results of the elections.

The DPP will face an uphill battle to further diversify its economy away from the mainland for two reasons. First, the DPP must collaborate with the opposition on economic policies, and this may mean strengthening relations with China. Second, President Tsai did not manage to strike a single trade deal during her tenure, not even with Taiwan's most natural allies, such as the US or Japan. This was not really because of division in Taiwan's yuan as it was fully control during the DPP but rather by the lack of opportunities. In fact, even with Tsai Ing-wen, highly regarded thanks to her handling of the COVID-19 pandemic and her support to Ukraine, she still did not manage to get Taiwan into any trade deal. Taiwan's official application to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in 2021 seems to have been frozen due to fears of the reaction from the mainland. In fact, Australia's Prime Minister Albert Albanese, a member of CPTTP and a clear US ally, recently expressed doubts about Taiwan's ever being able to join CPTTP. In the same vein, US President Biden also did not include Taiwan in his economic initiative for the region, the Indo-Pacific Economic Framework which was launched in Tokyo in May 2022. Given the US's, Japan's and Australia's are unwilling to close trade deals with Taiwan, it seems highly unlikely tha the EU is able to o reopen the possibility of negotiations on an investment agreement with Taiwan. This could be a missed opportunity for the EU because not much can be changed in terms of signing a trade/ investment deal so Taiwan's girating towards the EU will need to be business-driven, which will not be easy, especially given that the KMT will try to redirect the Taiwanese economy towards Mainland China.

In the next sections we offer more detail about the evolution fo the Taiwanese economy as well as the degree of diversification it has already achieved. This will be the basis to assess what may happen as the DPP next term starts, even if with a much more constrained room for manuover. Some conclusions are offered as to why all this matters for the European Union.

### **Impact on economic policies**

In its campaign, the DPP made it clear that further geographical diversification of the Taiwanese economy away from the mainland is in Taiwan's interest. Geographical diversification has happened faster for Taiwanese outbound foreign direct investment (FDI) than for trade. Taiwan's FDI decreased from 65% during the KMT's last administration (from 2008-2016) to 35% during DPP's last two terms under President Tsai Ing-wen. While the government did push for the so-called 'South Bound Policy' to invest in ASEAN countries and in India, the big increase in FDI into Japan, the United States and Germany in the semiconductor space is likely more market-driven.

For trade, the diversification process began more recently. Exports to the mainland have been very resilient, even during Trump's trade war. Trade exports increased in 2020 to more than 40% of total exports. Exports to the mainland have decreased since then and stand at 35% today. How much this diversification process should be seen as a geopolitical move as a move to 'de-risk' trade is yet unknown. The surge in Taiwan's outbound FDI – through large investments in semiconductor labs in the US, Japan and Germany – could put Taiwan's famous silicon shield

at risk, especially if the technology to produce the world's most advanced semiconductors is transferred out of Taiwan.

So far, the EU has not benefitted much from Taiwan's trade and investment diversification, at least when compared to the US and the rest of Asia. The lack of a trade or investment deal could be considered important, but some of Taiwan's other trading partners are also in this position. Considering that the EU is the largest foreign direct investor in Taiwan, one wonders whether the EU should attempt to foster more bilateral economic relations. This could include increasing EU exports to Taiwan and taking advantage of outbound FDI from Taiwan in the technology space.

Down the line, the DPP will face an uphill battle to further diversify its economy away from the mainland for two reasons. First, the DPP must collaborate with the opposition on economic policies, and this may mean strengthening relations with China.

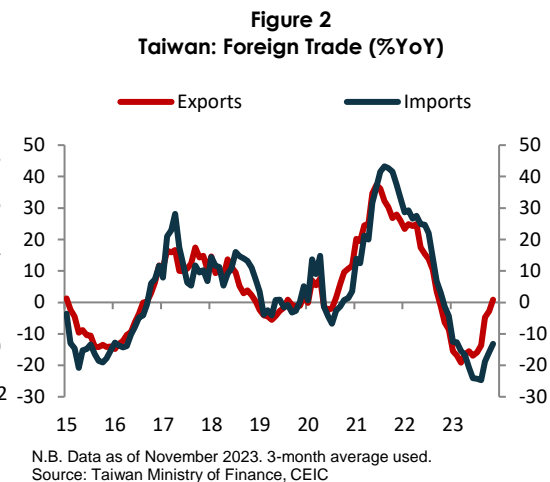
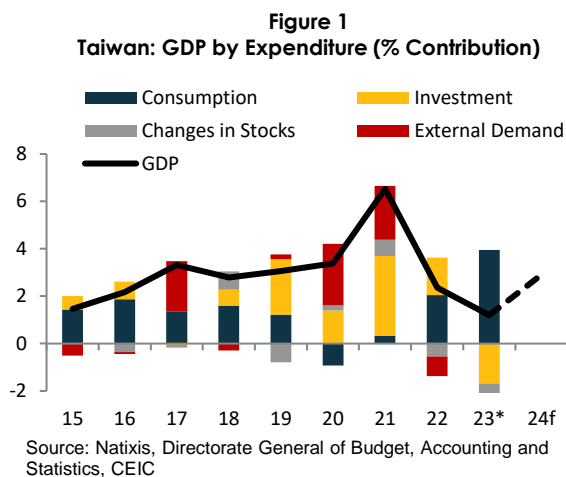
Second, President Tsai did not manage to strike a single trade deal during her tenure, mostly because of her handling of the Covid pandemic and Taiwan's position on the war in Ukraine. Furthermore, Taiwan's official application to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in 2021 seems to have been frozen, according to comments made by Australia's Prime Minister Albert Albanese. In the same vein, Biden did not include Taiwan in his economic initiative for the region, the Indo-Pacific Economic Framework which was launched in Tokyo in May 2022. It seems that the US, Japan and Australia are unwilling to close trade deals with Taiwan, which would put the EU in a difficult position if it were to reopen the possibility of negotiations on an investment agreement with Taiwan.

Taiwan's elections show that the Taiwanese want to maintain a democratic society while also wanting to mitigate hostilities with mainland China. The DPP has been chosen for a third mandate, but it now faces tighter checks and balances. The DPP's economic policies need to reflect this new reality, and as such, trade and investment diversification away from the mainland may slow down. This could be a missed opportunity for the EU because not much can be changed on the institutional front, based on what countries closer to Taiwan like the US, Japan and Australia are doing. One would expect that European companies might still push for opportunities in Taiwan given its growth track record, technological comparative advantage and large outbound investment.

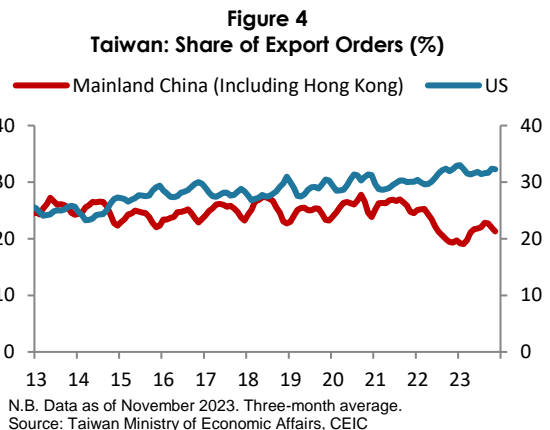
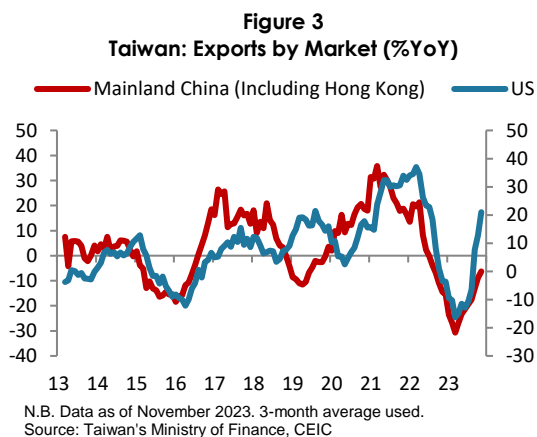
## 2. Where does the Taiwanese economy stand?

### Exports lagging but with signs of recovery

Taiwan will likely end 2023 with a growth rate of 1.2%, after the strong average annual growth of 4.2% between 2020 and 2022 (**Figure 1**). The main reason is the poor external demand dragged down by high interest rates and excess inventory in semiconductors and electronics (**Figure 2**). However, exports recovered during the last months of 2023, suggesting the worst is over.



While the ICT cycle downturn is now past, it has clearly been a severe shock for the Taiwanese economy, highly export oriented, but the situation is improving quickly with major export orders, mostly from the US and very much related to the revolution in Artificial Intelligence (**Figure 3**). In fact, the US is becoming much more important for Taiwanese exports, as can be seen from export orders, mostly of semiconductors. From 2014 to 2023, the share of export orders destined for the US grew from 25% to 32%, while for the mainland, it fell to 21% (**Figure 4**).

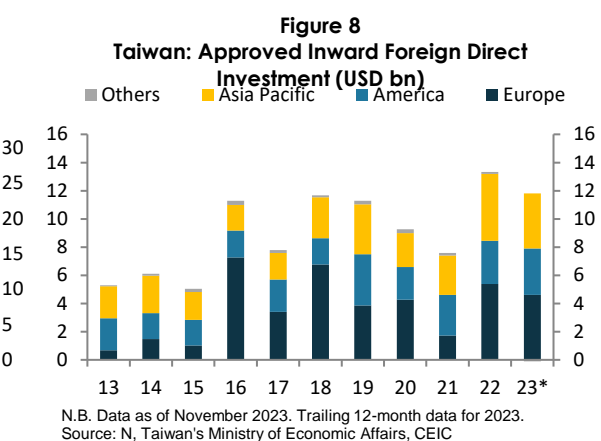
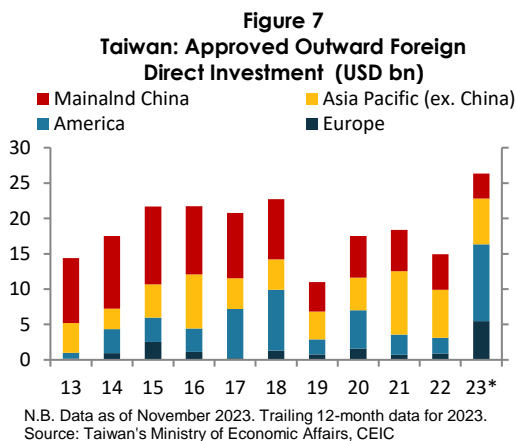
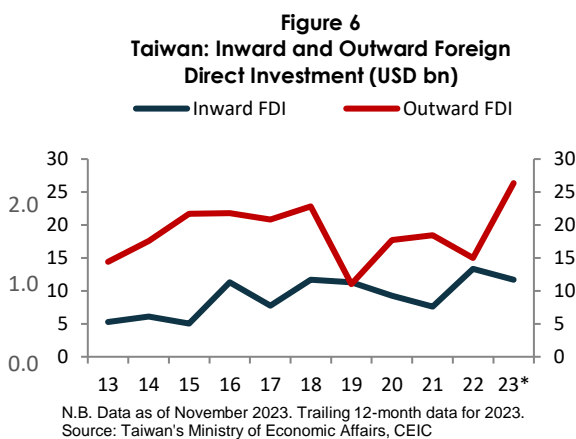
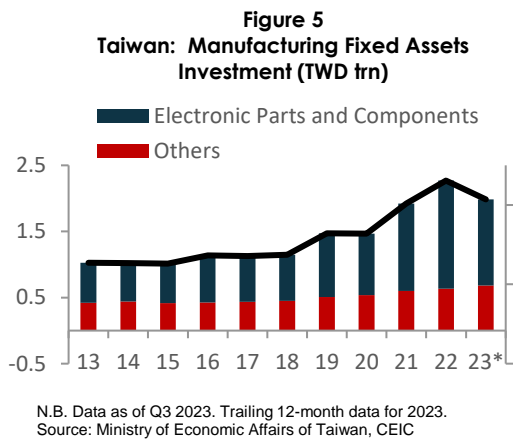


### Proactive overseas investment

The negative sentiment surrounding exports has also affected fixed asset investment in Taiwan, leading to a rare contraction (**Figure 5**). At the same time, Taiwanese firms have become more proactive in investing overseas, especially by opening semiconductor fabrication plants in the US, Japan and Europe (**Figure 6**). Outbound foreign investment has also been directed towards Southeast Asia for electronics and low-end semiconductor farms, and other low-end manufacturing (**Figure 7**). Taiwanese companies' reducing their investment in the mainland is important for China at a time when foreign direct investment is falling and considering that Taiwan continues to hold the largest stock of FDI in the mainland. In fact, Taiwanese were the first to invest in the mainland even before it entered the World Trade Organization (WTO).

While Taiwan is becoming a major overseas investor, it is not yet attracting as much foreign direct investment as the government was expecting. Still, the bulk of the foreign investment into Taiwan comes from the European Union but it is very concentrated in one sector: offshore

windfarms for China's energy transition (**Figures 6 and 8**). Discussions with foreign investors in Taiwan point to geopolitical risk becoming increasingly important for investors with a long-term horizon.

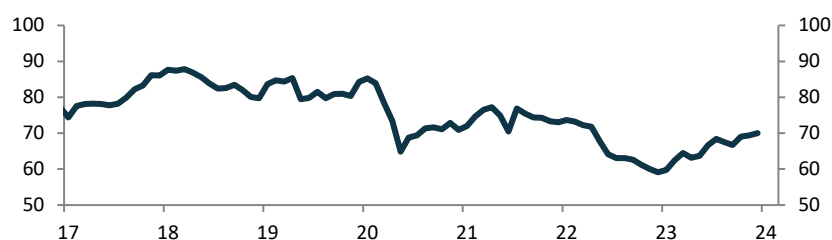


### Strong consumption notwithstanding rising geopolitical risk

Taiwan escaped a recession in 2023 thanks to strong domestic consumption (**Figure 1**). The government's policy of offering wage increases to civil servants, the military and public-school teachers helped, as did job-market stability. Taiwanese consumers did not show any sign of tempering their consumption because of pre-election anxiety (**Figure 9**). This shows the usual Taiwanese calm in the face of potential cross-strait tensions, compared to the concern felt in the international community, including long-term investors.



**Figure 9**  
**Taiwan: Consumer Confidence Index**



N.B. Data as of December 2023.

### Moving ahead

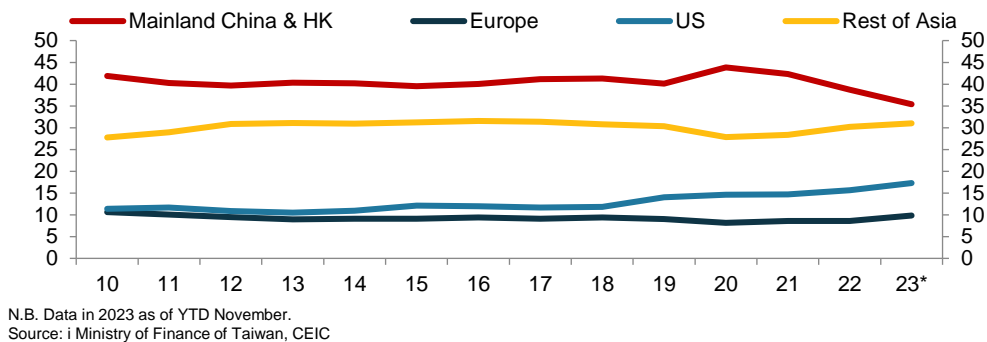
The election victors look set to benefit from economic tailwinds in 2024. Firstly, the export cycle is clearly improving. Second, expected interest rate cuts in the US should create a better environment for investment, especially outbound FDI as it is generally financed overseas. As for domestic fixed asset investment in Taiwan, renewed growth is expected now the uncertainty around the elections is out of the way. The fact that the DPP presidency will be more constrained in the Legislative Yuan could also be positive for investment by reducing the risk of extreme positions in relation to Mainland China and also on the economic side. Finally, on investment, very rapid growth in construction can be expected, to increase the supply of housing, which was a major issue during the election campaign for all parties, especially the TTP, the support of which the DPP needs.

Notwithstanding the rather positive outlook, risks remain, starting with potential retaliation from China.

## 3. How much has the Taiwanese economy diversified?

Mainland China remains Taiwan's biggest export and investment destination, but their economic relations are losing steam. The share of Taiwan's exports going to China was reduced from 40% on average between 2016 and 2019 to 35% in 2023 (**Figure 10**). Not even the KMT's landmark free trade agreement with Mainland China in 2010 – the Economic Cooperation Framework Agreement (ECFA) – led to an increase in Taiwanese exports to the mainland. The COVID-19 pandemic in 2020 triggered a sharp increase as the rest of the world entered a deep recession, but the trend did not last. On the contrary, the share of Taiwanese exports going to the mainland has dropped significantly since 2021, also influenced by US export controls on high-end semiconductors, with a clear knock-on effect on Taiwanese exporters.

**Figure 10**  
**Exports Destination Share by Value (%)**

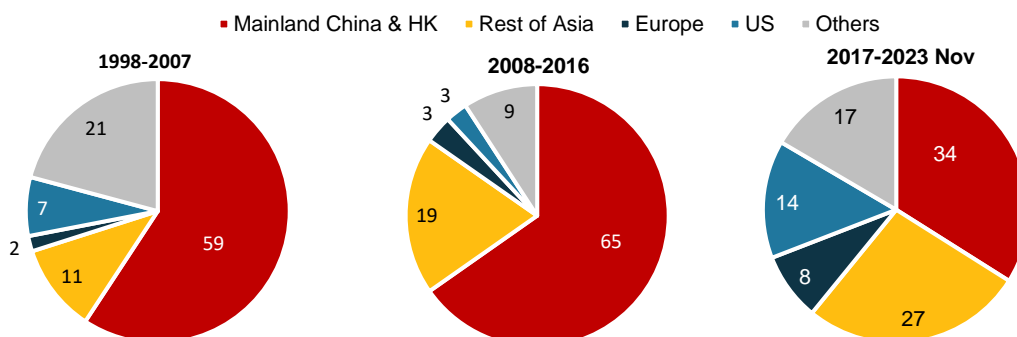


Taiwanese FDI into mainland China has also been shrinking rapidly, from 65% during the last KMT government in 2008-2016 to 34% during the most recent DPP government from 2017-2023 (Figure 11).

There are both geopolitical and economic reasons for this. Firstly, the trade and investment agreement reached under the first term of KMT President Ma Ying-jeou (EFCA I) was not extended as President Ma expected. In particular, negotiations on an EFCA II, which started in 2012 (after President Ma secured a second term) and were to include technological cooperation, finance and people-to-people exchanges, were not completed because of a lack of consensus among the main political parties, increased tensions in the Taiwan Straits and student protests in Taiwan (the so-called Sunflower movement).

With the DPP victory in 2016, the new South-Bound Policy was launched, offering tax incentives to strengthen investment and trade ties with the 10 ASEAN countries, India and six other South Asian nations. Investment in infrastructure was a major objective. In addition, rising labour costs in Mainland China, the ongoing trade war between the US and China, an increased regulatory burden in the mainland and political tensions between the two sides of the Taiwan Strait also pushed Taiwanese businesses to look elsewhere to invest.

**Figure 11**  
**Outward Direct Investment Destination Share by Value (%)**



N.B. Data in 2023 as of YTD November.  
Source: Ministry of Economic Affairs of Taiwan, CEIC

## 4. Taiwan's economic policies after the elections

The Taiwanese economy should experience a cyclical rebound in 2024, but significant post-election economic choices remain to be made when President Lai starts his term in May 2024.

Taiwan's housing prices have skyrocketed for the past few years, which has become a social problem, especially for the youth. In addition, the population is aging very rapidly which presents additional challenges, especially in the light of very limited immigration.

Still, the most contentious issue is the economic relationship with Mainland China. While the election-winning DPP wants to see further diversification away from the mainland, the KMT (with one more seat in the Legislative Yuan) wants a reinforcement of economic relations with China. The position on this issue of the third party, the TTP, remains unclear, creating uncertainty. Other differences appear in terms of sectoral diversification and energy policies.

All three main parties align on social and labour policies, including the need to raise the minimum wage, address the worsening affordability of housing, especially for young people, and offer incentives to increase the fertility rate. On the difficult issue of economic relations with China, the DPP remains convinced of the need to reduce economic dependence on mainland China and increase geographical diversification. National security is the most important reason for this, but the Chinese economy is also slowing and is becoming more costly to operate in, especially when compared to Southeast Asia and India.

President Lai is widely expected to retain current president's Tsai Ing-wen's policies of de-risking – or reducing reliance on potentially vulnerable suppliers – but the question is whether he will be able to do so, either because the DPP does not control the Legislative Yuan or because other countries are not really offering Taiwan diversification opportunities. In particular, incoming President Lai has said that Taiwan should continue to push to be part of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), after having applied in September 2021. The DPP considers the other major trade agreement in Asia, the Regional Comprehensive Economic Partnership (RCEP), off-limits for Taiwan since China is already a member and membership would require Taiwan to formally accept the 1992 consensus on the One China policy<sup>1</sup>. More specifically, the DPP is likely offer more fiscal incentives to promote diversification in Southeast Asia and India, beyond the economic forces arising from the large demand for semiconductors from the United States. Lai has also made it clear that he will continue to support industrial policies for Taiwan to become instrumental in global artificial intelligence (AI) developments, especially as far as chip fabrication is concerned. In other words, the DPP will push geographical diversification, away from the mainland, but not sectoral diversification, and in any case, such economic policies will need to the support of either the KMT or the TTP in the Legislative Yuan, or no supporting legislation will be able to pass.

The KMT wants better cross-strait economic cooperation, including negotiations on an extension of the current ECFA. How much the TTP will support the KMT in this will be key for

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<sup>1</sup> <https://asia.nikkei.com/Economy/Trade/Taiwan-casts-net-for-trade-deals-as-China-blocks-RCEP-entry>.

assessing the future of ECFA. TTP leader Ko Wen-jie expressed favourable views about ECFA during the election campaign, in line with his overall pragmatism. Now the campaign is over, it remains to be seen which side he will take on this issue. Beyond ECFA, and in stark contrast to the DPP, Ko Wen-jie has expressed a preference for Taiwan's participation in the RCEP.

Finally, two important policy areas are energy and industrial policy. On the former, the DPP has long maintained a very strong stance against nuclear energy, and has proposed a rapid increase in the use of renewable energy. However, during Tsai Ing-wen's administration, Taiwan started several offshore wind projects but only three have progressed enough to start generating electricity. Given Tsai Ing-wen's bold announcement in 2021 that Taiwan would achieve net-zero emissions by 2050, the DPP position on nuclear energy seems difficult to maintain, especially as it is in opposition to the KMT's and TTP's views on the energy transition, and given Taiwan's current fossil-fuel – especially coal – dependent energy mix. On industrial policy, both the DPP and the KMT remain very supportive of the semiconductor industry, while TTP's Ke Wen-jie has said he considers Taiwan's economy excessively concentrated in one single industry. Interestingly, his ideas for diversification are still closely related to the semiconductor industry, including space technology.

## 5. Conclusions

The results of Taiwan's 13 January 2024 elections show little fear among voters about any potential retaliation from Mainland China, as the DPP's candidate Lai was chosen with over 40% of the votes. However, Taiwanese voters decided not to give the DPP all of the power, as was the case in the two previous administrations. The KMT obtained one more seat than the DPP in Legislative Yuan and, thereby secured the speaker of the Yuan on February 1.

This implies that the third – much more recent – party, the TTP, will hold the key to the control of the Legislative Yuan and, thereby, to the evolution of economic policies among other factors.

Positive news for the incoming government comes from the economic tailwinds expected for 2024, with GDP growth more than doubling. This will be mainly driven by a much more positive cycle for the electronics and semiconductor sectors, but by more rapidly growing fixed asset investment, once the uncertainty surrounding the elections has been cleared. Nevertheless, some of the economic policies framed under the DPP's administration for the last eight years will need to be reshaped, given the need for the DPP to seek consensus. This possibly includes the ongoing diversification of Taiwan's trade and investment away from Mainland China and towards the rest of Asia and the US. This may have consequences for the European Union, which has so far benefitted little from Taiwan's diversification. Beyond the geopolitical reasons that may lead Taiwanese companies to prefer to invest in the US or Japan, the EU should also be able to attract more foreign direct investment from Taiwan. This will be all the more important given Taiwan's growing role in advanced technology, in particular in advanced semiconductors, which are becoming even more crucial because of the artificial intelligence revolution. It should be acknowledged, though, that the possibility of the EU starting negotiations with Taiwan on a trade/investment agreement seems distant given Taiwan's increasing isolation when pursuing bilateral and regional agreements, whether with the US or Japan or within the region, after Taiwan's official request in 2021 to be part of CPTPP.



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