

Wang, Hao

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Cross-disciplinary viewpoint

Hao Wang*

National identities and cross-strait relations: challenges to Taiwan's economic development

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Abstract: In the increasingly volatile global political order, national economic structures and international relations, integrated as they are, are showing concerning signs of strain. Taiwan, whose world-leading semiconductor industry is indispensable in Global Supply Chains and whose economic prosperity and security are critical to a stable global economic system, has received much research interest since the late 1980s. Against the background of a slowing Taiwanese economy, starting in the 2000s, this paper seeks to investigate the causes of Taiwan's challenges and the linkages to the global economy vis-à-vis China. Based on previous research from different social science disciplines, this paper shows that Taiwan's economic performance has been undermined by the declining effectiveness of its industrial policy and the general state intervention in the country, which is in turn caused by deep socio-political divisions on issues of national identity and Taiwan-China relations. The paper reveals the dilemma, which results from this.

Keywords: Taiwanese economy, national identity, cross-strait relations, China

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1 Introduction

Thanks to its exponential economic growth after World War II, Taiwan has come to hold an important position in the global economy, especially in international trade networks. As of 2020, Taiwan was the 22nd largest economy

worldwide, with an overall GDP of \$669.25 billion (current price, U.S. dollars) (IMF 2022). In the same year, Taiwan was the world's 15th largest exporter (Ministry of Economic Affairs, Republic of China 2022) and a top trading partner for many countries and regions. The total estimated trade value of goods and services between the U.S. and Taiwan was \$105.9 billion in 2020, making Taiwan the U.S.'s 9th largest trading partner (Office of the United States Trade Representative 2020). Additionally, Taiwan is an indispensable part of Global Supply Chains (GSCs), largely thanks to its semiconductor sector. Since the 2000s, firms in the IT hardware manufacturing industries have gradually established significant partnerships with top technology firms worldwide, providing critical components in the manufacturing of personal computers, smartphones, automotive vehicles, etc. For example, Taiwan Semiconductor Manufacturing Corporation Limited (TSMC), one of the largest firms in Taiwan and the largest semiconductor foundry in the world, contributed a staggering half to global chip production in 2021.

China, the second-largest economy in the world and a rising hegemon in the Asia-Pacific, has long claimed sovereignty over Taiwan and is taking increasingly drastic actions to change the status quo of Taiwan's de facto independence (Mastro 2021). These actions threaten not only Taiwan but also regional security and the stability of the international trade system. The COVID-19 pandemic has exposed the fragility of current GSCs, suggesting that a major disruption (e.g., a military conflict around the Taiwan Strait) could harshly interrupt the global economy. Rising U.S.-China tensions in recent years have further fueled the concern that China intends to challenge U.S. dominance in the current international order in a variety of areas, among which the status of Taiwan seems a priority (Zeng et al. 2015).

The security of Taiwan, and, by extension, geopolitical stability in the region and around the world, depends not only on diplomatic support but also on its economic growth and social cohesion. A stagnant economy with wealth and opportunities unequally distributed may, for instance, cause social unrest and political turmoil, which undermine the country's ability to respond to external

*Corresponding author: Hao Wang, University of Toronto, Department of Geography & Planning, Sidney Smith Hall, 100 St. George Street, Toronto, ON M5S 3G3, Canada; E-Mail: haow.wang@mail.utoronto.ca

shocks, such as natural disasters and military conflicts, thereby possibly opening a window of opportunity for military intervention for China. Taiwan was once characterized by rapid economic growth in the latter half of the twentieth century with an average annual GDP growth rate of 9.19 percent between 1952 to 1995 (National Statistics 2022). This economic leap in Taiwan is known as the “Taiwan Miracle” (Gold 2015). Worryingly, since democratization in the 1990s, Taiwan has experienced a slowdown in economic growth. The annual GDP growth rate between 1996 – the year of the first presidential election – and 2019 decreased to 4.09 percent – less than half the growth rate of the proceeding decades. It further dropped to 2.88 percent after the 2010s (National Statistics 2022). This slowdown is concerning, given Taiwan's geopolitical and geoeconomic importance.

This paper examines the root causes of Taiwan's economic slowdown. The analysis places the Taiwanese economy in a broader context, and encompasses research on geopolitical dynamics, Taiwan's domestic politics, and economic geography. While each strand of research investigates regional economic dynamics from different angles, most arguments focus on limited facets of this issue. For instance, the political economy of international development research stresses state-society relations and the role state institutions play in shaping economic actors' behaviors; but it pays less attention to how economic policies produce tangible growth. This focus on a single aspect of analysis, however, is not able to adequately address the complexity of the phenomenon as a whole.

By adopting an interdisciplinary approach, this paper hopes to bridge the gap between economic geography, geopolitics, and political economy; and to further our understanding of regional economies in an increasingly uncertain and unstable international order. Taiwan, a late-coming but prosperous liberal democracy at the front-line of superpower competition, provides us with a valuable opportunity to observe, explore, and explain economic dynamics from different angles. As such, this paper seeks to contribute to a relational understanding of the global economy (Bathelt & Glückler 2003) by extending beyond the conventional view of economy-centered single-country investigations. Rather than attempting to explain the decades-long political and economic transformation of a society based on a narrow set of factors, this paper adopts a relational analysis. That is, it incorporates the interactions of multiple agents and institutions across countries and considers historical contingencies, path-dependent evolution, as well as idiosyncratic contexts.

The analysis presented in this paper is largely historical and interpretative. Using descriptive data and findings

from the literature, this paper relies upon an understanding of path dependence, which argues that an initial set of causal forces triggers the change in a particular direction and that the mechanism of “increasing returns” reinforces the trajectory of changes (Mahoney 2003; Martin & Sunley 2022). For example, the initial establishment of external and minority rule over Taiwan in the late-1940s set in motion two changes to Taiwan's domestic and external political-economic context: divisiveness on national identity and a hostile neighboring country. Democratization, which occurred during the 1990s, is another trigger that shaped and reinforced trends: the two-party system enlarged divisiveness and confrontation between their supporters, while the achievement of self-governance drove Taiwan apart from authoritarian China. This caused further hostile relations across the Taiwan Strait. In future studies, it may be interesting to test these trends more broadly based on comprehensive statistical data.

The remainder of this paper is organized as follows: Section 2 provides a review of existing research on dynamic trajectories of the national/regional economy of Taiwan, followed by a brief explanation of the conceptual framework adopted in this paper. Section 3 describes the origin of Taiwan's identity issue, and how this issue evolved during the post-war period and led to political polarization. Section 4 explains how political polarization around this identity issue affects Taiwan's economic growth. Section 5 shows how unsolved cross-Strait relations have deepened the political division, thereby exacerbating problems in the already slowing-down economy. Finally, section 6 summarizes and concludes.

2 Theoretical background and research concept

Research in the fields of economic geography and regional studies about Taiwan and other East Asian economies has long sought to understand the mechanisms behind the country's (or the broader region's) decades-long, rapid economic growth. Researchers have paid particular attention to catching-up processes (Wong, J. 2000), referring to Newly Industrialized Countries (NICs) (Jenkins 1991). In this context, capital accumulation and efficient investments were identified as key drivers of the industrial upgrading process, from labor-intensive to capital-intensive sectors (Young 1994; Kim & Lau 1996). Researchers also found that the accumulation of human capital, largely attributable to the prevalence of a specific culture of education, was critical to the development of

labor skills and economic growth (Yusuf & Stiglitz 2001; Ouyang & Ma 2013; Hanushek & Woessmann 2016). This stream of research, which focuses on the impacts of factor inputs (mainly capital and labor), sometimes neglects the contribution of technological capacity-building. Evidence shows, however, that firms in East Asia have benefited remarkably from technology transfers within the region, especially during the initial phase of industrial upgrading, following an “OEM-ODM-OBM migration route”¹ (Tho 1993; Hobday 1995).

As Taiwan, along with other Asian Tiger countries, transitioned from an industrial to a knowledge-based economy, the country successfully closed the technology gap with advanced economies – in some areas, even gaining a lead over traditional developed economies (Wong, P. K. 1999). Throughout this process, innovation became a primary driver of development (Wong, J. 2012). On the one hand, Taiwan's national innovation system supports innovation-based development through high R&D spending (Lee & von Tunzelmann 2005), strong agglomeration of related industries in science parks (Hasan et al. 2016), industrial clustering and evolution (Mathews 1997; Guerrieri & Pietrobelli 2004; Lee & Saxenian 2007), and extended innovation networks (Wong, P. K. 1999; Dodgson et al. 2008). On the other hand, innovation is supported by the deep integration of the country's industries into the global economy. Embeddedness in Global Production Networks (GPNs) has become a pivotal strategy to promote economic growth and technological development in NICs (Coe et al. 2008). For instance, global investment and trade, as well as labor mobility, fuel technological transfers between different countries and regions, through either permanent mechanisms such as transnational entrepreneurs (Henn & Bathelt 2017) or temporary channels such as trade fairs (Bathelt et al. 2014). With the rise of the semiconductor industry in Taiwan, active participation in GPNs has strongly benefitted the industry by “facilitating the technology leveraging and knowledge diffusion” (Poon 2004: 130). Specific mechanisms of knowledge diffusion include the transfer of technological and institutional know-how through the Taiwanese technological community in Silicon Valley (Saxenian 2006) and state-supported trade fairs (Chang et al. 2015).

The changing role of the state in promoting Taiwan's economic growth and the broader relationship between economic growth and institution-building have also been a major focus of research at the intersection of economic geography and political economy. Institutions are critical in shaping economic action and interaction, as they are mediators of both structural forces and agencies (Bathelt & Glückler 2014). The state in East Asian countries, a specific institutional actor, has heavily utilized economic development policies to pursue rapid growth. This was particularly true during the period of industrial upgrading when state apparatuses distorted the economy, suppressed consumption, and manipulated price signals and exchange rates in favor of investment and exports in certain industries. This active state-intervention model has become widely known as the “developmental state” (Amsden 1994; Amsden & Chu 2003; Wade 2018). This notion does not refer to a monopolistic role of the state, nor does it attribute the economic rise solely to heavy state intervention. Rather, it suggests that the state never replaces market forces but is complementary to them. As such, the level of state intervention in East Asia can be viewed as a medium to economic success, compared to other developing countries such as India and some Latin American economies (Jenkins 1991; World Bank 1994; Stiglitz 1996).

The concept of the developmental state is not free of criticism in the literature (Pempel 1999). Indeed, the 1997 Asian financial crisis revealed that clientelism and relationship-based rule reduced the transparency and autonomy of firm operations and contributed to increased corruption within the bureaucracy, undermining the efficiency of market mechanisms (Evans 1998; Li 2003; Wong, J. 2004). More importantly, the conventional regime of the developmental state no longer seems feasible under changing domestic and international political and economic circumstances. Integration into the global economy has decreased the level of embeddedness of firms and regions within the domestic economy and increased the level of embeddedness in other types of networks, such as GPNs and World City Networks, fundamentally weakening the state's capacity to govern the market (Wong, J. 2004; Yeung 2013). Governments in Taiwan and other East Asian countries seem to have lost their “map for catch-up” and their authority of guiding firms on how to proceed after entering the innovation-driven knowledge-based economy in the face of increased uncertainty (Wong, J. 2004).

While the slowdown of Taiwan's economy has received much less attention than the development before, a few researchers have explored this change – from two perspectives: One perspective emphasizes the role of China, stating

¹ OEM (Original Equipment Manufacturing), ODM (Original Design Manufacturing), and OBM (Original Brand Manufacturing) refer to different setups of manufacturing operations. They differ according to the degree to which designing, manufacturing, and other activities are outsourced. A detailed explanation of these terms and the route can be seen in a study by Lee et al. (2015) on small and medium enterprises (SMEs) in Korea.

that China has sought to marginalize Taiwan's economy through numerous means: by drawing the investment of Taiwanese firms away from Taiwan and into China, offering financial and other incentives to attract Taiwanese high-tech firms, and competing with Taiwan on absorbing international capital (Yeh 2009). The other perspective focuses on the reduced effectiveness of economic policies, especially those with a focus on industrial upgrading (Chu, W. W. 2020). This perspective argues that while criticism of the developmental state is warranted, the state does have options in lifting the economy, including the provision of critical infrastructure to meet commercial demand and developing strategic trade relations with certain countries. However, ineffective state intervention fails to produce the intended results, and the decrease in effectiveness in turn is caused by an erosion of what is referred to as "embedded autonomy." From this perspective, to generate effective policies and implement them successfully, the state needs to be embedded in societal-economic networks to draw broad support from different actors, while at the same time a degree of autonomy is necessary to prevent it from being captured by interest groups (Evans 1995; Amsden & Chu 2003; Chu, W. W. 2020).

While both perspectives offer important insights, they do not include the overall global landscape. The first perspective captures the negative impact of economic competition between countries in an unfriendly geopolitical environment but fails to account for Taiwan's declining appetite for cooperation with China despite the palpable economic opportunities that may result from it (Brown et al. 2010). The second perspective may reflect the "paradox of embeddedness" (Granovetter 1985; Uzzi 1997), but omits the dominant influence of China on shaping both Taiwan's external environment and domestic political climate.

This paper addresses the corresponding void in the literature and provides a more holistic analysis of current economic and political interrelationships. This paper suggests that post-democratization, Taiwan's society was deeply polarized after the 1990s, in part due to the Kuomintang (KMT)'s² prior heavy-handed authoritarian rule. Such polarization in turn has eroded the relative autonomy and cohesiveness of state policymaking. Furthermore, the unresolved issue of Taiwan's sovereignty, which stems from a critical historical juncture that occurred more

than seventy years ago, has also created a dilemma for Taiwanese society: how should it handle trade relations and commerce with China?

The divisiveness and polarization did not arise in a vacuum, nor should it be blamed on the democratization process per se. Rather, one should return to the critical juncture of the Chinese Civil War in the late 1940s. The relocation of the KMT government to Taiwan upon its defeat in the war left the Taiwanese with two unsolved issues (Jiang 2017): (i) with respect to national identity, who should they self-identify with (Taiwanese or Chinese) and where should they belong to (Taiwan or China); (ii) with respect to the relationship with China, should Taiwan develop close economic and other ties with China, despite China's territorial ambition for Taiwan, or not? These two issues are interrelated, and they impact Taiwan's economic growth to this day.

Shortly after the end of World War II and the Sino-Japanese War in 1945, the Kuomintang-led government of the Republic of China and the military forces of the Communist Party of China (CPC) fought each other over control of China. The war broke out in 1945 and ended in the success of the CPC in 1949. The CPC later formed a new regime in mainland China, while the former KMT government retreated to Taiwan – the only territory that was not occupied by the CPC regime. The retreat of the KMT brought about the resettlement of over one million people across the strait to Taiwan, which was about one-seventh of the total population of 8.4 million people in Taiwan in 1955 (Wakabayashi 2016). Correspondingly, the KMT government and migrants from the mainland brought a Chinese identity to Taiwan.³ For decades, the KMT government, whose top leadership posts were almost exclusively staffed with Chinese mainlanders, suppressed Taiwanese identity and activities pursuing the independence of Taiwan through state violence and propaganda. Nevertheless, Taiwanese national identity gradually developed and grew among the population and flourished after democratization, much to the dismay of the CPC. The two identities in Taiwan clashed over important issues, especially the economic and political relationship with China. In recent years, however, the Taiwanese national identity has become dominant (Jiang 2017) and China's Taiwan policies have over-powered the identity issue and become the new main source of debate and conflict within Taiwanese society (Chu, W. W. 2020). On the one hand, China continues to claim sovereignty over Taiwan and threatens

² The Kuomintang is also referred to as the Chinese Nationalist Party. The Kuomintang was the sole ruling party of the Republic of China during the authoritarian period which can be roughly divided into two phases according to its de facto rule: from 1928 to 1949, it controlled most areas of China, and from 1949 to 1987, it built a one-party autocracy in Taiwan until the martial law was lifted in 1987 and the process of democratization of Taiwan began.

³ The self-identity of Taiwan's residents was also predominantly Chinese until the early years of democratization in the early-1990s (Jiang 2017).

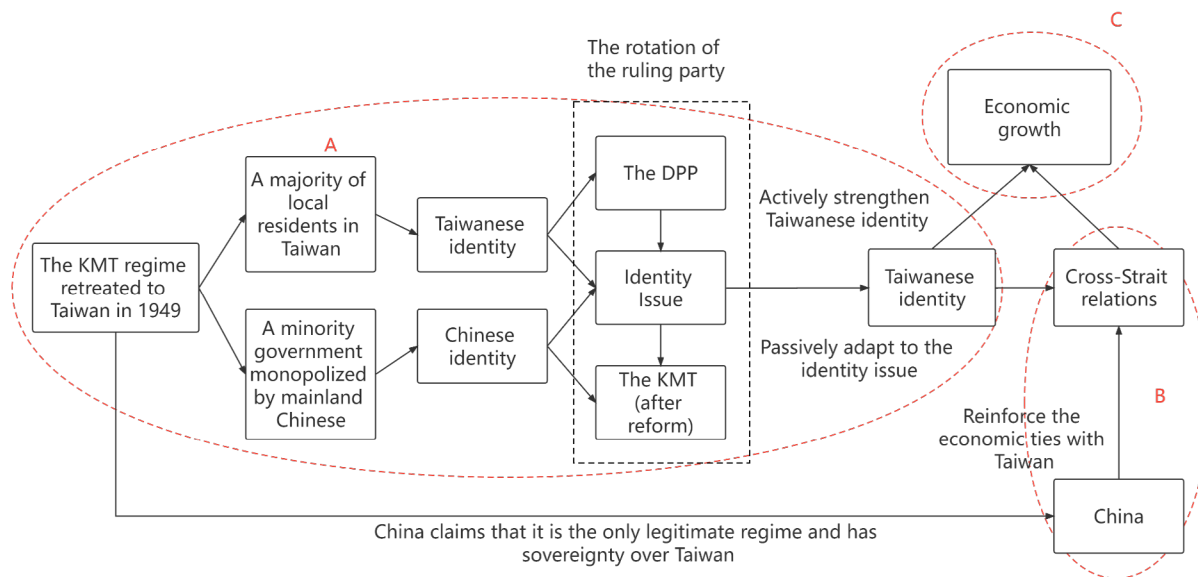


Figure 1: Conceptual framework: The Co-evolution of the national identity issues and cross-Straits relations

KMT: Kuomintang (the Chinese Nationalist Party)

DPP: Democratic Progressive Party

the use of force. On the other hand, China uses economic influence to increase ties with Taiwan and create economic dependencies (Lai 2022). These policies have thus put Taiwan in a dilemma where political sovereignty conflicts with economic incentives. This dilemma exacerbates divisive politics in Taiwan and has led to wild policy swings and political gridlocks. Both of the major political parties in Taiwan today (KMT and Democratic Progressive Party, or DPP) are polarizing their supporters within Taiwan, and this hyper-politicization forces the ruling party to make decisions based on political appeal rather than economic and technical expertise (Chu, W. W. 2020).

To reiterate, economic policy-making in Taiwan is thus captured by two considerations: (a) the national identity issue and (b) cross-Straits relations. The two issues are difficult to separate, and the focus of contention has shifted over time: from taking a standpoint in the national identity issue to economic positioning in cross-Straits relations. A relational perspective of the influences at play is shown in schematic form in Figure 1.

In the following sections, I elaborate on the origin and evolution of Taiwan's national identity issue (area A), discuss how the focus shifted to cross-Straits relations (area B), and argue that these two influencers have primarily propelled the economic slowdown in Taiwan (area C).

3 Origin and evolution of the national identity issue

Since the KMT's takeover of Taiwan, there have always been contradictory views between officials with origin in mainland China and local residents in Taiwan. In 1949, when the KMT government was forced to retreat to Taiwan, it became a "minority ruler" with a sense of distrust among native Taiwanese residents (Wu, Y. 2005).

At the same time, Japan's colonial legacies in Taiwan helped the KMT in building an authoritarian government. On the one hand, Taiwan was a fragmented society in the 1940s. In order to maintain its colonial rule, Japanese colonists exerted tight political control and excluded the vast majority of local residents from participating in colonial governance and the management of large enterprises (Wu, Y. 2005). As a result, many social organizations were prohibited and the political connections among Taiwanese were disrupted. In this social context, the KMT government was able to continue an authoritarian rule in a similar way and establish large-scale state-owned businesses in Taiwan based on Japanese assets (some state-owned enterprises that were moved to Taiwan from mainland China) (Wang, J. H. 2011). The establishment of such an economy was very important, as it strengthened the KMT government and provided broader societal support (Wu, Y. 2005; Wang, J. H. 2011).

In order to maintain and consolidate its authoritarian rule, the KMT government used mixed strategies, such

as the construction of internal legitimacy by emphasizing Chinese identity and heightening societal control through suppressing the Taiwanese identity. For instance, by reinforcing historical education which suggests that Taiwan had been a part of China, the KMT government proclaimed itself to be the only legitimate government of China (especially vis-a-vis the international community) (Wakabayashi 2016). This effort put China, rather than Taiwan itself, at the center of identity narratives. Control over society also involved an internal reorganization of the KMT, the party's penetration of government departments, and martial law that particularly targeting speech and associations promoting Taiwanese independence (Chu, Y. H. 2011).

Since the 1970s, however, with the easing of Sino-U.S. relations, most countries started to acknowledge that the People's Republic of China ruled by the CPC is the only legitimate government of China. Through this, the external legitimacy of the KMT regime in Taiwan was undermined. By then, a large middle class had emerged in Taiwan after decades of economic development. This middle class was not satisfied with long-term low wages, which supported the government's agenda to achieve high capital accumulation and investment activity, and requested the government to change related policies. This request then turned into demands for political rights, putting intense pressure on the KMT government (Tang 2006). At first, the government repressed these contentions harshly through martial law. However, such repression did not deter protest but stirred resistance against authoritarianism. In this process, two sources stimulated the rise of a Taiwanese consciousness (Yu & Kwan 2008), which brought the Taiwanese identity to the public and prompted its spread.

The first source was Taiwanese residents themselves. Before the process of democratization, harsh suppression had made the Taiwanese public increasingly view the KMT government as an external ruler and opposed a Chinese identity. Activists and residents who participated in pro-democracy movements hoped to find legitimacy for their actions by constructing a Taiwanese identity. Many of these activists later became the founders of the DPP which was based on a Taiwanese consciousness and the principle of the eventual and full-scale independence of Taiwan (Wakabayashi 2016).

The second source came from within the KMT itself. Facing democratization pressures both domestically and internationally (especially from the U.S.), the KMT government sought to appeal to local elites by co-opting highly educated young people. In the mid-1980s, its leader Chiang Ching-kuo decided to start a liberalization processes, and with his passing away in 1988, the authoritarian rule

ended. Lee Teng-hui, the first Taiwan-born chairman of the KMT, succeeded Chiang Ching-kuo and initiated further political reforms in support of liberalization and democratization. He argued that the original KMT was a foreign ruler and accelerated the party's localization and that it should be transformed into a "modern democratic party belonging to Taiwan" (Change, M. K. 2011: 103). Lee Teng-hui further unilaterally proclaimed the end of the civil war between the KMT and the CPC and instituted direct presidential elections, hoping to build state-to-state relations with China. Both proclamations of localization and independence strengthened Taiwanese consciousness within society. But such radical proclamations and the temporary alignment between the DPP and Lee Teng-hui caused the KMT to split (Lin, J. W. 2011), reflecting what had happened at the societal level more broadly.

The rise of a Taiwanese identity did not mean the former Chinese identity faded away immediately, as the democratic transition of Taiwan was a gradual process facilitated by the authoritarian KMT. After democratization, KMT was not rejected by the Taiwanese people but became one of the two main parties and inherited supporters of the old regime. As such, in the early years of democracy, the gap with respect to a consensus on national identity became a hotspot of contention combined with the fragmentation of social classes. On the one side, the KMT still had a large number of supporters mainly living in northern Taiwan: including original migrants from mainland China, their descendants, and those Taiwanese with economic ties to China (Wu, Y. S. 2005). The KMT thus was able to continue clinging to a Chinese identity. These KMT supporters mainly lived in the northern part of Taiwan, many of which belonged to upper-middle and upper economic classes (Chu, Y. H. 2011). On the other side, those who supported the DPP mainly live in the southern region of Taiwan and tended to be poorer (Chu, Y. H. 2011; Lin, T. H. 2015). Moreover, civil servants, military personnel, teachers, as well as employees of large enterprises tended to vote for the KMT, while small and medium-sized enterprise staff, self-employed, and farmers in the south were more likely to support the DPP (Lin, T. H. 2015). As such this political division had created real regional economic disparities (Dicken 1998).

The different national identities among Taiwanese citizens gradually turned into divergent political preferences and support for the two different parties. Both parties aimed to gain votes to win elections by polarizing their attitudes against one another, and thus created political confrontation along with the distinct inequalities between classes and between regions in Taiwan. Studies in the recently emerging field of "geography of discontent"

(Lenzi & Perucca 2021) show that interregional disparities and interpersonal inequalities have been important sources of political discontent (Rodríguez-Pose 2018; Lenzi & Perucca 2021). Such discontent, in turn, reinforced and is still reinforcing the divisiveness between the two parties and their supporters.

Because the identity issue is at the heart of the basic societal consensus within Taiwan, many social and economic policies cannot be tackled independently from it. As a result, deliberations on non-political issues have been politicized and have had a distinct impact on overall economic performance.

4 Intensified conflicts and harmful influence on economic growth

Polarization in democracies has attracted much attention in political science research. One uncontroversial finding of this line of research is that such polarization causes policy gridlock (Mickey et al. 2017; McCoy et al. 2018; Iyengar et al. 2019). This indeed occurred in Taiwan.

The first reason for the gridlock is the antagonism of the two parties, in particular when legislative and administrative powers are controlled separately, while the second reason results from public pressure. In the presidential election in 2000, DPP candidate Chen Shui-bian won to replace the KMT as the ruling party, but the Taiwan parliament was still controlled by the KMT at the time. As a result, the DPP government was faced with the situation of a small ruling party with a large opposition, and the KMT rejected the DPP's policy proposals continuously using its legislative majority (Chang, M. K. 2011). The DPP, in turn, sought to gain support by resorting policy questions to the issues of national identity and cross-strait relations. The argument was that as a representative of Taiwanese identity, only the DPP could take care of Taiwan's real interests. Hence, the question of cross-strait relations has become the core conflict between the parties, as well as between the different classes and regions in Taiwan. Some Taiwanese scholars point out that Taiwan has fallen into the trap of dual-polarized politics between the "blue and green," as a result of which economic issues are severely marginalized (Chu, W. W. 2020).

Such polarized participation and intensified conflicts had two types of negative impacts on economic growth: stagnation in industrial upgrading and the development of a relatively unattractive investment environment. As aforementioned, the Taiwan economic miracle was credited to developmental state strategies, specifically

export-oriented industrial upgrading, in which state interventions were critical (Amsden 1994; Woo-Cumings 1999; Wong, J. 2000; Amsden & Chu 2003; Wade 2004). However, the model has weaknesses. From a national perspective, overly relying on a few pillar industries increases the weakness of an economy if the pace of upgrading for these key industries slows down. Unlike Japan and South Korea, Taiwan's economy was overly focused on its information technology and semiconductor industries since before the 2000s (Chu, W. W. 2020). Because of the intensified global competition in these industries, the profits of Taiwanese enterprises decreased significantly and affected overall economic growth performance (Chu, W. W. 2020).

Confronting these problems, the Taiwanese government attempted to continue successful industrial policies to promote industrial upgrading. Since the late 1990s, it put forward several industrial upgrading plans, such as the "Two-Trillion Double-Star Industrial Development Plan (2002)," "Regulations on Industrial Innovation (2010)," "Action Plan on Industrial Upgrading and Transformation (2014)," and "5+2 Industrial Innovation Plan (2018)." But the effects of these policies are not obvious. Currently, no industry can replace the role of the information technology and semiconductor industries (Chu, W. W. 2020). Unlike manufacturing industries, the knowledge-based economy is based on continued radical and incremental innovation, which requires more risky investments and stability in expectations regarding policies. Because the ruling parties in power tended to change policies of previous governments, many industrial policies were discontinued, time intervals to launch new plans were getting shorter, and more industries were covered in the plans (Chu, W. W. 2020). Overall, policy targets were more scattered. One may say that the Taiwanese government and its leaders lacked a clear vision, since the design and implementation of industrial policies were so difficult. However, it is more likely that the underlying logic of policymaking has changed. For fear of losing the support of the median voter, when facing controversy, the ruling party was reluctant to express their views explicitly, while the opposition party tended to encourage voters to exert pressure on the government. As a result, the focus of public participation was on opposition and protest, even when the government offered seemingly rational and feasible solutions.

Besides inconsistent and discontinuous policies, the investment environment also worsened and reduced the willingness to make investments. In particular, resources, such as industrial land, water, and electricity, were in severe shortage and had become more difficult to meet for Taiwanese companies, sometimes, it even caused serious interruptions in business and manufacturing activities.

The worst case was a massive electricity blackout in August 2017, which affected more than five million households (BBC 2022) and harmed Taiwanese firms' confidence in the government (Central News Agency 2017). The electricity shortage reignited the debate whether to maintain and extend nuclear power in Taiwan to increase the electricity supply as the construction of nuclear power plants already got stuck in the polarized political process.

In the beginning, the controversies around nuclear power plants largely originated from environmental concerns and involved only a few environmental organizations and activists. As pointed out by Sen (2000), pluralistic values provide major advantages in democracy and are not necessarily the root cause of tensions. As such opposition to nuclear power simply meant that participants placed environmental protection ahead of economic development. The problem, however, was a lack of deep and inclusive discussions on this issue. Instead, long-lasting animosities were reconstructed. After the Fukushima nuclear accident, many ordinary residents joined environmental organizations to oppose the development of nuclear energy, despite the fact that Taiwan's electricity generation capacity was not able to meet the requirements of economic growth. This created a dilemma for the government. Instead of encouraging further public deliberation, both parties resorted to gaining public support through rounds of referendums (Grano 2017), creating frustration within the industry which needed this necessary infrastructure. This partly explains why investments in Taiwan have stagnated since the turn of the 21st century. The gross fixed capital formation was 22 percent of GDP in the 1970s but plummets to only 7.2 percent since the 2010s (Chu, W. W. 2020).

To sum up, under the developmental state model in the authoritarian period, the KMT government saw economic growth as an important source of legitimacy. Its leaders had a strong will to support economic development, and were often able to coordinate policies to reach a consensus when facing conflicting goals. When a consensus was difficult to reach, leaders' personal power also helped to ensure the implementation of policies. Overall, in recent years, political parties have not only lacked a strong determination to develop the economy, but also seemingly did not have the capacity to implement new policies effectively. In the context of polarization and a lack of basic consensus, opposing political parties deliberately used divisive strategies to subvert economic policies.

5 From national identity to cross-strait relations

The pending conclusion of the Chinese civil war from the 1940s has left unresolved cross-strait relations, as China, the self-proclaimed winner of the civil war, keeps demanding sovereignty over Taiwan. The unsettled sovereignty issue has affected the Taiwanese economy in three ways.

First, it exacerbated the divisions on identity issues in Taiwan until the mid-2010s. Both parties realized the importance to gain support among voter groups that share the same identity and used different policy tools, especially public education, to do so. The 2000–2008 DPP administration first launched a revision of school curricula, aimed at putting more emphasis on Taiwan's own history. Since then, the proportion of people supporting a Taiwanese identity has continuously increased (Hughes & Stone 2009). In 2008, after the KMT regained power, it hoped, reversely, to promote a Chinese identity through similar policies, but encountered strong opposition from student groups, teachers, and other population groups. The plan to revise curricula was eventually dropped (Stolojan 2017). Overall, we may conclude that the Taiwanese identity has eventually taken a foothold hold in Taiwan. Regarding cross-strait relations, the choice is thus no longer unification or independence, but rather independence – or maintaining the status quo. According to a survey conducted by the Taiwan Foundation for Democracy (2018), more than 70 percent of Taiwanese people favored maintaining the status quo and legal independence regarding cross-strait relations.

Second, it caused diverging opinions in terms of Taiwan's economic positioning: should Taiwan introduce a series of economic policies to develop closer economic ties with China? The KMT and DPP, as well as their supporters, have different answers. The KMT suggests building and maintaining closer economic ties with China, not only because it feels more affinity toward a Chinese identity, but also because of potential economic benefits of deeper integration with the rapidly-growing Chinese economy. Research in the New Economic Geography (NEG) and other fields emphasizes such advantages of economic integration, related to increasing returns and knowledge spillovers from agglomeration (Scotchmer & Thisse 1992; Henderson 2007), lower transaction costs (Dicken & Lloyd 1990; Ascani et al. 2012), and reverse knowledge flows generated by outward foreign direct investments (OFDIs) (Bathelt & Li 2020). All of these advantages also apply to Taiwan-China economic relations (Fuller 2008).

In contrast, the DPP is more concerned about too much dependence on China as a result of economic

integration. Importantly, the Chinese economy is in a process of rapid industrial upgrading. Given the Chinese economy's size and the Chinese government's policies to attract foreign direct investments and human capital from Taiwan, observers have warned that the Taiwanese economy may get "hollowed out" due to the relocation of Taiwanese firms and skilled workers to China (Chen 2004; Rigger 2015).

After 2008, when the KMT won both the presidential and legislative elections, it implemented policies to strengthen economic, trade, and cultural cooperation with China. Similarly, China also introduced corresponding policies with respect to Taiwan. As a result, the degree of integration between the two has substantially increased (Jiang 2017). With China growing into the world's second-largest economy, Taiwan's economy has become more reliant on trade with China.⁴ Anti-China sentiments, however, caused controversy. Many people, especially young people with a strong Taiwanese identity, worry that Taiwan's growing economic dependence on China will erode Taiwan's political independence (Beckershoff 2017). Some oppose any sort of economic and trade relations with China and advocate for suspending existing linkages. In 2014, in opposition to the Cross-Strait Service Trade Agreement (CSSTA) between Taiwan and China, a protest supported by the DPP broke out, leading to a period of occupation of the Taiwan parliament. The movement ultimately forced the government to shelve the agreement (Beckershoff 2017), which caused a sharp drop in voter support for the KMT government. In 2016, the government was replaced by the DPP administration and, since then, relations across the Taiwan Strait have cooled down rapidly (Jiang 2017).

Still, Taiwan has not been able to formulate an alternative economic development vision and plan (Chu, W. W. 2020). Instead, inconsistencies in Taiwanese economic policies between central and local governments have been characteristic. In 2016, the DPP put forward the "New Southern Policy," hoping to reduce its dependence on China's economy by developing economic and trade linkages with Southeast Asian countries. In 2018, the KMT won 15 of 22 counties and municipalities in local government elections, and these local governments immediately announced plans to strengthen economic and trade linkages with China, as many firms with economic ties to China continued to hope for more exchange and openness (Shen 2019).

Third, as an exogenous omni-present power, China has not been silent but implemented policies that directly affect Taiwan, and which have increased tensions regarding the issue of economic positioning. China's current policy of cross-strait relations aims, as a whole, at "promoting peaceful reunification while not giving up the use of force" (Qin 2022). In terms of specific policies, China tends to strengthen economic and cultural ties with Taiwan but, at the same time, through economic threats, boycotts, and the threat to military intervention reduces the space for Taiwan to participate as an independent political entity in the world. Recently, China has changed its Taiwan-policies, shifting from pure economic incentive policies to mixed policies which combine competitive aspects with incentives for Taiwanese citizens and businesses in China (Wang & Lee 2020; Lai 2022). Overall, it has become more difficult for Taiwan to benefit from trading relations with China (Beckershoff 2017). In many industries, especially Taiwan's key industries, businesses are facing a decline in market shares and profits, partly because of the competition with Chinese firms (Chu, W. W. 2020). This hurts the Taiwanese economy further.

6 Conclusion

Since the mid-2010s, the future of an integrated global economy has been a cause for concern in the face of multiple challenges, such as the rise of anti-globalization attitudes and populist politics in western advanced economies and growing global and regional geopolitical tensions. Under these circumstances, Taiwan's national security and the role of its economy as a key player in GSCs, and as well a focus of superpower competition, are more important than ever to maintain stability in the current international economic system.

To contribute to a more comprehensive understanding of the slowdown of the Taiwanese economy since the mid-1990s, this paper examines the historical and current factors that have led to a decline in the efficacy of the state's interventions in the economy, which was essential to the rapid growth in the prior period. My analysis suggests that the current challenge to Taiwan's economic growth is derived from its internally divisive politics and geopolitical and geoeconomic environment. Specifically, since the early years after democratization in the 1990s, two opposing national identities that had long existed in postwar Taiwan, and the political conflicts surrounding these identities, have become increasingly apparent. Due to a lacking consensus regarding this fundamental

⁴ China was Taiwan's largest trade partner, accounting for 25.2 percent of total trade and 21.6 percent of imports in 2021 (International Trade Administration 2022).

issue, the division between the two major parties and their respective voters has increased and created a polarized society. As a result, the room for open, rational, and scientific discussions of socio-economic problems has become tight and squeezed. Instead, mutual attacks of the two parties and their supporters on each other's identity affiliation are dominating.

While the Taiwanese identity is now being shared by the majority of the Taiwanese population, unclear relations with China, which derived from the unresolved Chinese Civil War more than seventy years ago, have become a new source of division. In spite of China's economic importance to the Taiwanese economy, a large part of the Taiwanese population has developed sentiments against the political risk and economic dependence caused by close cross-strait relations, while the rest of the population supports even closer economic ties with China to benefit from the growth of the world's second largest economy, despite long-standing ambitions of China to integrate Taiwan into a "one China" territory. China, in the meantime, uses mixed strategies to further divide political agendas and the public in Taiwan. These issues of national identity and cross-strait relations, though differing in influence over the past decades, are direct sources that create polarized politics and reduce the effectiveness of the state interventions in Taiwan.

The findings of this paper are highly relevant to academic research in political economy, economic geography and related disciplines, and especially in policy development. My analysis highlights a dilemma faced by Taiwan's political and economic actors and, in fact, the entire world today: Taiwan is unique in having a powerful neighbor that is politically hostile, economically beneficial, and historically connected. On the one hand, as the growing acceptance of a Taiwanese identity makes a peaceful reunification of Taiwan and China less likely, the Chinese government stresses its determination to defend the "one China" principle (Huang 2017). This national identity issue may thus provoke military intervention in the future. On the other hand, closer economic ties across the Taiwan Strait provide China with opportunities to impose its enormous economic influence on Taiwan and weaken Taiwan's capacity for self-governance, which may open doors for Chinese interventions, or even involvement, in Taiwan's politics. In other words, extreme scenarios of this dilemma may have the same outcome: either provoking or inviting China's intervention in Taiwan and threatening Taiwan's sovereignty. This tricky situation calls for comprehensive, creative, and careful strategies to cope with these issues and to develop some middle-ground. To be clear: this is not a localized political issue that concerns only China and Taiwan, as any negligent or careless move of either of

the two could lead to drastic changes in the regional geopolitical configuration and lead to violent conflict or even war. Each of the scenarios would put massive strains on the already fragile global economic system and threaten highly-sensitive GVCs globally.

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