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Analysts Weigh In on What Lies Ahead for US-Taiwan Economic Relations

By: Zoë Weaver-Lee

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In August this year, the Global Taiwan Institute (GTI) gathered ten analysts in Washington, DC as the "US-Taiwan Economic Relations Working Group" to discuss the challenges and opportunities facing the US-Taiwan economic relationship. This article compiles thoughtful insights from the working group, which convened for a one-day workshop to outline key priorities for policy makers in both the United States and Taiwan with the goal of ensuring continued benefits from the US-Taiwan economic relationship in multiple dimensions.

The workshop took place on the heels of major developments in the US-Taiwan relationship. Earlier in the month, US President Donald Trump's administration announced that Taiwan would be subject to a "temporary" 20 percent tariff while negotiations were ongoing–a relatively higher rate than that of other trade partners in the region. Despite this rate being lower than the initial 32 percent, and only applying to about a quarter of Taiwan's US-bound exports, many in Taiwan were quick to criticize Taiwan President Lai Ching-te's (賴清德) administration for failing to secure a better deal. For further context, the announcement also followed the Democratic Progressive Party's (DPP, 民進黨) failure to secure their intended outcome from the "Great Recall Movement," as well as reports that President Lai's possible transit through the United States had been cancelled. Although the cause of the latter is still debated, such an environment has directed immense pressure toward Lai from an already US-skeptical Taiwanese populace to secure a more equitable tariff rate.

Given these developments, GTI's US-Taiwan Economic Relations Working Group set out to reframe the US-Taiwan economic relationship and chart its course for the coming years. In the August workshop, the group developed five central priorities: 1) lowering the trade deficit; 2) mitigating the impacts of the tariffs; 3) focusing on new areas of cooperation; 4) navigating domestic pressures; and 5) planning for long-term contingencies.

Priority 1: Lowering the Trade Deficit

At the start of the workshop, most analysts identified the biggest challenge in US-Taiwan economic relations to be the ongoing negotiations to balance the trade deficit between

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the two sides in order to secure a lower tariff rate. As a group, workshop analysts cited "reducing tariffs and other trade barriers" as the number one priority for the United States when it comes to economic engagement with Taiwan.

Given the high demand for artificial intelligence (AI) and semiconductor technologies, we can assume that demand for Taiwan's exports will not decline in the United States. While Taiwan negotiates a better tariff rate, Taiwan should instead focus on what it can purchase from the United States in order to balance bilateral trade. Throughout the workshop discussions, participants frequently mentioned areas of opportunity that included arms purchases and other defense industry cooperation, natural gas, and additional semiconductor investments.

While the United States continues to clear the backlog of arms packages to Taiwan, Taipei should employ further arms purchases as a method for lowering the bilateral trade deficit. For example, even as Taiwan continues to nurture its domestic drone industry, Taiwanese companies can work with American manufacturers or at another point in the supply chain to build an integrated manufacturing ecosystem involving imports from the United States.

On the natural gas front, President Lai has noted that US liquefied natural gas (LNG) purchases are not only a focus of the tariff negotiations, but also a priority for Taiwan's energy resilience considerations. In fact, Alaska Governor Mike Dunleavy announced in early August that a deal with Taiwan to purchase six million tons of LNG was close to finalization, although questions remain regarding whether the pipeline will be completed by the projected date of 2030.

When asked for the biggest area of opportunity in the US-Taiwan economic relationship, three analysts cited US investment in the semiconductor industry as being the most promising. Beyond reducing tariffs, the majority of analysts agreed that technology cooperation and supply chain resilience should be a priority in the United States' economic relations with Taiwan. While inbound investment will not directly affect the trade deficit, additional Taiwanese semiconductor investments into the United States seem to be a priority for the Trump Administration in negotiations to lower the tariff rate. According to President Trump, semiconductor companies with commitments to invest in the United States will be exempt from a proposed tariff of 100 percent on semiconductor imports. The proposed 100 percent tariff is especially significant considering that semiconductors and other electronics were temporarily fully exempt from US tariffs, but the outcome of the Section 232 investigations could change these standards. Taiwanese chipmaking giant Taiwan Semiconductor Manufacturing Co. (TSMC, 台灣積體電路製造股份有限公司) will likely remain exempt under these circumstances. This may not be the case, however, for many of Taiwan's smaller firms that make up Taiwan's robust chip ecosystem, which have less capital and flexibility to expand operations on US soil.

Priority 2: Mitigating the Impacts of US Tariffs

Amid ongoing uncertainty and risk, Taiwan's small and medium enterprises (SMEs)—which make up much of Taiwan's economy—have remained vulnerable. In response to the US reciprocal tariff policy, President Lai announced a special budget increase at the beginning of August to assist Taiwan's SMEs in "responding to this new tariff policy." As of August 29, the Legislative Yuan (立法院) passed provisions for an NTD 10,000 cash handout program aimed at "economic and social resilience" in light of the tariffs.

One workshop attendee raised the point that trade barriers can incentivize mergers, in that smaller technology firms will seek to combine with larger enterprises that are expected to be exempt from tariff forces. However, the analysts determined that such a trend is unlikely. Instead, smaller enterprises in the semiconductor industry are likely to invest in pre-existing US-based ecosystems, like that of Phoenix, Arizona.

Other questions surrounding the relocation of production were also discussed, such as the possibility that Taiwanese firms may move to other countries (for example, Mexico or Southeast Asia) where tariff rates are lower in relative terms. The analysts noted that such shifts are unlikely at this point for several reasons: 1) the initial wave of Taiwanese manufacturing departing China for Taiwan or Southeast Asia was already composed of companies willing and able to move, so another wave is unlikely at this time; 2) the tariff rates in the region are roughly similar; and 3) the move would be costly and would take years, by which time US tariff rates will likely have changed.

As such, given that tariff negotiations could have long-term implications, Taiwan should focus on supporting its small and medium enterprises as they navigate uncertainty.

Priority 3: Focusing on New Areas of Growth

As evidenced by fractious US-Taiwan trade negotia-

tions, the diversification of Taiwan's economy remains a key step to resiliency. Several areas of opportunity can serve as a new frontier for US-Taiwan cooperation outside of semiconductors: including AI regulation, batteries, the critical minerals supply chain, and drone production.

Four analysts specified AI technology regulation and investment as the biggest area of opportunity in US-Taiwan economic relations. Whether in the form of more integrated hardware-software partnerships with Taiwan's AI-optimized semiconductor manufacturers or on joint standards-setting, a shared vision for the future of AI would be to the benefit of both the United States and Taiwan. In early August, a bipartisan group of US lawmakers introduced a bill to enhance defense technology cooperation with Taiwan in multiple areas, including in AI, drones, and chips. Recent reports also note that Taiwan's National Chung-Shan Institute of Science and Technology (國家中山科學研究院) has signed a memorandum of understanding with US-based Anduril industries, which signals a direct collaboration on the use of AI for defense technologies. These developments could serve as a valuable foundation through which to expand the pre-existing US-Taiwan AI partnership.

Another opportunity for collaboration between the United States and Taiwan could be found in the field of battery technology innovation. Considering the bipartisan support in the United States for investment in such technology—as well as the United States' general lag in the industry—Taiwan could contribute its expertise in development and manufacturing. Such collaboration would also be significant in the context of US-China competition, given that China leads the world in battery manufacturing, with nearly 85 percent of global battery cell production capacity.

China's dominance on critical minerals also presents a unique opportunity for US-Taiwan cooperation. While Taiwan's exact role remains uncertain (as it does not necessarily offer specific expertise or resources in the area), one possible opportunity may be to look at Taiwan's manufacturing advantages, which could be used in the refining process. More environmentally-conscious methods of refinement are also an area for growth that Taiwan can explore.

Priority 4: Navigating Domestic Pressures

Domestic political strife in Taiwan and the United States may not be the biggest challenge facing the economic relationship, but it is shaping the context of engagement. Most analysts in our working group noted in initial polling that Taiwan's domestic political challenges would likely spill over into its economic relationship with the United States (five analysts responded "strongly agree"), but the recent passage of the special budgetary act signals that the Legislative Yuan is heading in the right direction. Under the Trump Administration, the United States has evolved beyond Biden-era discussions of export controls and industrial policy toward a focus on rebalancing the trade deficit, which fundamentally limits Taiwan's bargaining space. The Lai Administration has been cautious to release details related to the ongoing negotiations—a move perhaps intended to maintain confidence in Taiwanese industries—but the Trump Administration has recently announced that a potential agreement has been reached.

If both Taiwan and the United States can skillfully navigate domestic politics, key developments could take US-Taiwan economic relations to the next level. In the United States, finding creative ways to pass the stalled double taxation agreement, which has bipartisan and private sector support, would be key to lowering barriers to US-Taiwan investment. In Taiwan, possible revisions to the *Public Debt Act* (公共債務法) could shift resources, changing the landscape for SME support, technology research and development, and defense procurements.

Priority 5: Planning for Long-Term Contingencies

Planning for a contingency in the Taiwan Strait should be viewed as a key economic consideration for both the United States and Taiwan. Building up deterrence through speedy arms procurements, enhancing private sector resilience and communication, and making necessary investments in energy infrastructure should all be long-term priorities in the US-Taiwan relationship. The private sector will need to navigate the sensitivity of contingency discussions, and a hesitancy on the part of some political actors to create public panic through general discussions about resilience. This can be achieved through a focus on sectoral strength, supply chain integrity, and transparent communication–rather than discussions exclusively focused on a blockade or armed conflict.

The main point: Considering recent developments in the US-Taiwan economic relationship, GTI convened a US-Taiwan Economic Relations Working Group in August 2025, featuring ten Washington-based experts in economics and trade. The working group formulated five key areas of priority for the next era of US-Taiwan economic partnership: 1) lowering the trade deficit; 2) mitigating the impacts of the tariffs; 3) focusing on

new areas of cooperation; 4) navigating domestic pressures; and 5) planning for long-term contingencies.

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Estimating the Cost of Appeasing China: Taiwan's Exclusion from the RCEP

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Introduction

The Regional Cooperation Economic Partnership (RCEP) is a major trade agreement featuring nations across the Indo-Pacific, with outsized representation from Southeast Asia. [1] However, the RCEP has never included Taiwan. Considering Taiwan's strong efforts to shift trade from China to Southeast Asia under the 2016 New Southbound Policy (NSP), RCEP members have few obvious economic reasons to exclude Taiwan. Rather, it is the People's Republic of China's (PRC) economic and political influence that significantly contributes to Taiwan's exclusion, similar to how the PRC wields its influence to limit Taiwan's access to other international organizations like the United Nations. Given China's considerable market power, most RCEP member countries tend to follow China's stance. [2] However, Taiwan's economic heft as the world's eighth-largest economy suggests that RCEP members may be incurring some kind of ongoing costs by excluding Taiwan from the trade liberalizing framework. [3]

This article uses economic modeling to determine whether RCEP members are facing ongoing costs by excluding Taiwan from the existing trade bloc. It will do this by estimating the net change to RCEP members' consumer welfare and gross domestic product (GDP) were Taiwan suddenly allowed to join RCEP. The study will also predict the economic impacts on Taiwan's simulated RCEP membership on four other targets: Taiwan, China, the United States, and the rest of the world. While the United States is not a member of RCEP, the ripple effects of reduced trade barriers between Taiwan and RCEP economies will have an impact on the United States' trade in the Indo-Pacific. [4] Given that the United States is a key geopolitical supporter of Taiwan, the question of whether Taiwan's theoretical RCEP membership would impact the US economy is relevant. While Washington may have geopolitical reasons for supporting or opposing Taiwan's RCEP membership, there is little understanding regarding whether the United States would face economic costs should Taiwan join.

Methodology

We employed the Computational General Equilibrium (CGE) model under the Global Trade Analysis Project (GTAP) as the primary methodology for conducting this policy experiment and measuring the shock. Known for its robust capabilities and detailed modeling of a country's global trade activities, GTAP is a key tool for analyzing trade shocks and conducting counterfactual simulations of regional integration. [5]

To simulate Taiwan's potential inclusion in the RCEP as part of Taiwan's New Southbound Policy, three key components are necessary: data, models, and experiments. For our policy experiment, we first utilized the GTAP 10 database, which is based on input-output tables of international trade published by governments worldwide. [6] Second, we adopted the standard GTAPv7 General Equilibrium model setup, widely used to represent open economies, using the default settings for the model. [7] Lastly, we introduced a shock (an immediate reduction) to the import tariffs between Taiwan and RCEP countries as a way to simulate Taiwan's sudden membership in the organization.

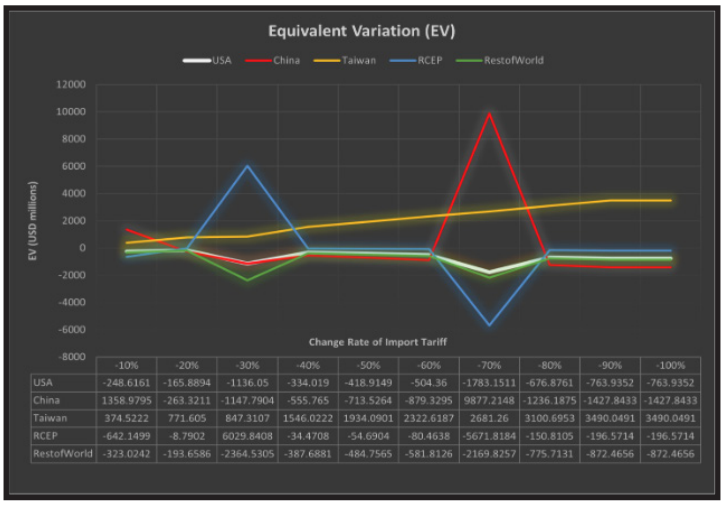
In order to measure the costs or benefits to RCEP countries, Taiwan, the United States, and the rest of the world that might stem from Taiwan's sudden RCEP membership, we employed the equivalent variation (EV) measure, which measures how changes in prices affect consumer welfare. Positive EV means that consumers are able to purchase more at the same level of income. We also modeled the impact to the GDP of RCEP nations, Taiwan, the United States, and all other countries combined, should Taiwan join—which is referred to as VGDP.

We first modeled the economic impacts of a sudden 10 percent reduction in bilateral tariffs between RCEP nations and Taiwan, before modelling more significant tariff reductions, increasing in increments to 100 percent. We also applied a 10 percent multiplier to these tariff shocks to simulate the knock-on effects of consumer spending.

Simulation Results

Figure 1 shows the welfare change measured by the monetary EV, for tariff reductions ranging from 10 percent to 100 percent. The vertical axis indicates the EV value, and the colored lines represent five groups of countries that are the focus of this study: the United

States, China, RCEP nations, Taiwan, and a combined group for the rest of the world, which we use to derive our results.

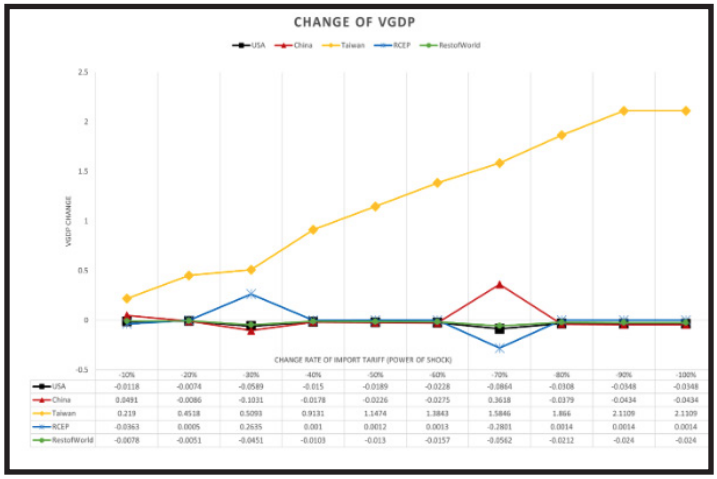


	-10%	-20%	-30%	-40%	-50%	-60%	-70%	-80%	-90%	-100%
USA	-248.6161	-165.8894	-1136.05	-334.019	-418.9149	-504.36	-1783.1511	-676.8761	-763.9352	-763.9352
China	1358.9795	-263.3211	-1147.7904	-555.765	-713.5264	-879.3295	9877.2148	-1236.1875	-1427.8433	-1427.8433
Taiwan	374.5222	771.605	847.3107	1546.0222	1934.0901	2322.6187	2681.26	3100.6953	3490.0491	3490.0491
RCEP	-642.1499	-8.7902	6029.8408	-34.4708	-54.6904	-80.4638	-5671.8184	-150.8105	-196.5714	-196.5714
RestofWorld	-323.0242	-193.6586	-2364.5305	-387.6881	-484.7565	-581.8126	-2169.8257	-775.7131	-872.4656	-872.4656

Figure 1: A graph showing the equivalent variation (EV) in consumer welfare for five country groupings should Taiwan experience sudden tariff reductions with RCEP members (Source: Created by the author.)

As can be observed from Figure 1, only Taiwan experiences consistent positive EV in models simulating sudden tariff reductions between Taiwan and RCEP member nations. The EV—which represents changes in consumer welfare—trends more positively as tariffs reductions precipitated by RCEP membership grow larger.

However, the EV is inconsistent or negligible for other country groupings should Taiwan join RCEP. China and RCEP nations experience either very little EV or sudden spikes and surges—which may be explained by model eccentricities.



	-10%	-20%	-30%	-40%	-50%	-60%	-70%	-80%	-90%	-100%
USA	-0.0118	-0.0074	-0.0589	-0.015	-0.0189	-0.0228	-0.0864	-0.0308	-0.0348	-0.0348
China	0.0491	-0.0086	-0.1031	-0.0178	-0.0226	-0.0275	0.3618	-0.0379	-0.0434	-0.0434
Taiwan	0.219	0.4518	0.5093	0.9131	1.1474	1.3843	1.5846	1.866	2.1109	2.1109
RCEP	-0.0363	0.0005	0.2635	0.001	0.0012	0.0013	-0.2801	0.0014	0.0014	0.0014
RestofWorld	-0.0078	-0.0051	-0.0451	-0.0103	-0.013	-0.0157	-0.0562	-0.0212	-0.024	-0.024

Figure 2: Graph simulating the changes in GDP precipitated by tariff reductions between Taiwan and RCEP members, ranging from 10 to 100 percent. (Source: Created by the author.)

Policy Implications

Several key conclusions can be drawn from the graphs. Firstly, the results suggest that Taiwan would clearly benefit if invited to join the RCEP. As shown in the results table, joining RCEP could provide benefits to Taiwan ranging from USD 354 million to USD 3,490 million. Even if Taiwan cannot enter the RCEP for geopolitical reasons, Taipei should consider accepting invitations for economic cooperation with Southeast Asian countries, particularly regarding tariff reductions.

Secondly, China appears to have few economic incentives to alter the current situation of Taiwan's exclusion from the RCEP, since including Taiwan in RCEP does not result in significant economic growth for China and the impact on China is relatively small. This reconfirms the presumption we had made: that Beijing is highly likely to direct the current exclusion of Taiwan. The asymmetry in economic impacts between Taiwan and China makes Taiwan's participation in the RCEP a politically powerful tool for China to use in dealing with Taiwan. However, as you can see in the diagram provided, in this general model, the impact on China is not linear. If Taiwan and the member states' tariffs are reduced to around 70 percent from the benchmark model, China could also benefit substantially. This indicates that China's usage of political influence against Taiwan incurs some economic loss for China as well.

Thirdly, the models suggest that RCEP countries themselves stand to benefit very little from Taiwan's membership when the tariff decreases are small. However, if the overall tariff decreases are larger than 30 percent from the benchmark model, RCEP countries could see an increase in their GDP growth. The Taiwanese government should not overlook these benefits. As Taipei continues to promote their existing New Southbound Policy—which aims to engage Southeast Asian nations (all of which are RCEP members)—the Taiwanese government should highlight the benefits that Southeast Asian partners would gain if the tariff rate is lowered past 30 percent. Additionally, suppose the membership of the RCEP is unattainable for Taiwan for a period of time. In that case, the Taiwanese government should still seek any bilateral trade agreements that could lead to a significant reduction in tariffs of goods between RCEP member countries and Taiwan.

Finally, the United States is expected to experience only minor negative economic impacts if Taiwan joins the RCEP (assuming that the United States is still not the member state of the RCEP). Because the negative effects are minor and a stronger Taiwan economy

benefits the United States' geopolitical interests, the United States gains more from Taiwan's inclusion in the RCEP than from its exclusion—especially considering Taiwan's unique geographical location and its role in the global supply chain of semiconductor products. Therefore, we advise the US government to address China's coercion of Taiwan through any available channels, and in the best scenario, both the United States and Taiwan should seek to join the RCEP to both maximize the benefits and reduce negative impacts.

Still, the issue of Taiwan's exclusion from the RCEP represents a small part of a larger problem. Although we can estimate the potential economic costs of Taiwan's exclusion from the RCEP using modeling, the costs of preventing Taiwan's exclusion from other international organizations are more difficult to determine, yet far greater. Taiwan's exclusion from the United

Nations, the World Health Organization, and International Monetary Fund blocked Taiwan from sharing its successful responses to global challenges—such as COVID-19, the 1998 Asian Financial Crisis, and the 2008 Subprime Mortgage Crisis—with other countries. By allowing China's influence to block Taiwan's participation in trade agreements and international organizations, economies and populations around the world will suffer the effects.

Conclusion

Taiwan's unique role in the Asia-Pacific has recently evolved into a delicate balance between economic benefits and political tensions stemming from the world's two most powerful countries, China and the United States. Taiwan has already signed a bilateral agreement with China, known as the Economic Cooperation Framework Agreement (ECFA, 海峽兩岸經濟合作架構協議). Currently, Taiwan and the United States are continuing to discuss the terms in the Economic Prosperity Partnership Dialogue (EPPD, 台美經濟繁榮貿易倡議), which is part of the framework announced by the Trump Administration in April 2025.

By modeling the effects of reduced tariffs, this article explored the economic benefits and losses that occur from Taiwan's exclusion from the RCEP. Through this modeling, it was revealed that Taiwan is the main beneficiary economically, although there are also economic benefits for RCEP nations and China. Additionally, while the United States would experience some negative effects, the impacts are relatively minor. From these results, the Taiwanese government may consider reevaluating the goals and strategies of Taiwan's New Southbound Policy while preparing potential proposals to join the RCEP. The current NSP appears to focus more on recruiting Southeast Asian students, tourists, and migrant workers to Taiwan, as well as encouraging Taiwanese firms to invest in Southeast Asia. As a result, it is more oriented towards increasing trade in the service sector. However, Taiwan could also benefit from lower tariffs with RCEP countries—many of which are also NSP partner nations. Therefore, if formal membership in the RCEP is not guaranteed in the near future, the Taiwan government should consider negotiating trade agreements with the RCEP nations individually.

The main point: Taiwan would benefit significantly from membership in the Regional Comprehensive Economic Partnership (RCEP). Its exclusion seems politically driven, resulting in real economic costs for RCEP, China, and global welfare. Taiwan should reevaluate its New Southbound Policy, pursue bilateral tariff reductions, and prepare proposals for future RCEP negotiations. This situation also highlights the broader impact of Taiwan's exclusion from other international organizations.

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Better Ahead Than Red: US-Taiwan Cooperation for Non-PRC Tech Supply Chains

By: Jonathan Marek

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In February 2025, Taiwan President Lai Ching-te (賴清德) outlined for the first time his vision for a "non-Red supply chain" (非紅供應鏈) that could be established among democratic societies to maintain technological leadership across a range of strategic sectors—and thereby reduce the geoeconomic leverage of the People's Republic of China (PRC). President Lai reemphasized this strategy in a May interview, in which he unsurprisingly highlighted the semiconductor industry as a priority target for the creation of a non-Red supply chain. While Lai has not yet turned this grand vision—which, given the depth of PRC engagement in critical supply chains and their overall complexity, may be difficult to operationalize—into specific policy steps, this framing reflects an astute, timely strategy to advance shared economic security objectives. The exaggerated nature of the PRC's reaction (with the State Council's Taiwan Affairs Office [國台辦] asserting that Lai's initial February announcement alone amounted to a step toward Taiwan independence that could "harm and destroy" the country) implies a recognition of the value of supply chain leverage to the PRC. The PRC's supply chain leverage has only become more apparent in light of reporting that US concerns regarding PRC restrictions on rare earth exports were one of the primary motivations behind Washington pursuing a trade ceasefire this summer.

Since PRC participation in any stage of a supply chain can pose risks to economic resilience, this comprehensive vision of a non-Red supply chain is necessary. For instance, if the PRC is removed from drone supply chains—but remains the primary supplier for the raw materials that are used in their batteries—the reduction in PRC leverage is minimal. Of course, this is not to say that every supply chain in a critical sector needs to be fully decoupled from the PRC. Such a goal is unrealistic and unnecessary. Rather, Taiwan and its democratic partners simply need to establish sufficient non-Red supply chains in critical sectors so as to deter the PRC from using its leverage coercively, and to mitigate the risks of disruption in case of a crisis or conflict. Following the PRC's 2010 effort to coerce Japan by restricting rare earth exports, Tokyo significantly reduced its reliance on PRC rare earths within a few years—and unsurprisingly, the PRC has refrained from further attempts to target Japan in this way.

The Logic and Value of Taiwan-US Supply Chain Cooperation

While other countries including Japan have taken steps towards diversification, Taiwan remains the obvious candidate for pioneering a non-Red supply chain. Firstly, the country possesses significant situational awareness regarding the PRC and its industrial policies—ironically, due in part to the fact that cross-Strait economic linkages remain relatively prevalent, but also as a result of the Taiwanese government's efforts to monitor risks emanating from the PRC. While governments have found it difficult to comprehensively map even a limited set of critical supply chains—as evidenced by the Biden Administration's abortive supply chain reviews—Taiwan is arguably better equipped than any country to achieve this.

Secondly, Taiwan has a unique set of experiences as well as preexisting policies capable of protecting its supply chains and preventing undue reliance on the PRC. Its bans on government procurement of PRC components appeared earlier, and were broader, than those of many other democratic governments. Taiwan has also launched a so-called "Drone National Team" indigenous drone development program, which aligns with the non-Red supply chain concept. Taiwan maintains strong, up-to-date legal frameworks to defend against PRC efforts to enhance its position in key supply chains through talent recruitment, economic espionage, and subsidies. The Taiwanese government pairs these frameworks with active enforcement measures to ensure that the policies are effective, such as a strong export control regime. These measures have been stress-tested over recent decades, during which the PRC has invested heavily in trying to carve out a place in leading-edge semiconductor fabrication. However, the PRC has decidedly failed in its efforts to dethrone Taiwan and TSMC, the latter of which has (regardless of export controls) deliberately kept its PRC-based fabs several technology generations behind.

Finally, Taiwan's innovation system and economic structure is well-suited to counter PRC strengths and carve out a competitive niche for non-Red supply chains. While Taiwan's labor market is certainly not as cost-competitive as the PRC's, the country's relatively low wages allow it to remain efficient in manufacturing. Taiwan has also begun to build a strong startup ecosystem, allowing it to diversify and respond to supply chain trends. Additionally, the Taiwanese government's long history of effective industrial policy aimed at achieving "catch-up" (which is related to but distinct from industrial policies that target frontier R&D) could provide a roadmap for seeking to wrest back a role in supply chains currently dominated by PRC firms. The strength of Taiwan's National Science and Technology Council (NSTC, 國家科學及技術委員會)-administered science parks as catalysts—not only of innovation, but also of actual manufacturing ecosystems and interlinked supply chains—represents a clear example of Taiwan's advantages.

As the Lai Administration continues to attempt to turn its non-Red supply chain vision into a reality, obvious areas for Taiwan-US cooperation have emerged. It is a positive sign that some of the earliest acknowledgements from Taiwanese officials—the Ministry of Foreign Affairs' (MOFA, 外交部) inclusion of the concept in a written report to the Legislative Yuan (LY, 立法院) and a comment from Minister of National Defense (國防部部長) Wellington Koo (顧立雄) on bilateral drone cooperation—have recognized that Taiwan's efforts will inherently benefit from alignment with the United States. Firstly, the United States remains Taiwan's largest geopolitical supporter, second-largest export market, and a key partner in advanced technology sectors. Secondly, both the US and Taiwanese governments have prioritized the semiconductor and drone sectors.

Priority Sectors for Cooperation

As noted above, Taiwan has already taken a number of steps to maintain a non-Red supply chain in semiconductors, and US-Taiwan export control cooperation is likely to continue to expand in this area. However, research shows that Chinese firms maintain central roles downstream of Taiwan and the United States in the area of assembly, test, and packaging (ATP). While ATP is traditionally a relatively low-value add sector, it is nevertheless necessary to turn even the most advanced chip from a useless piece of silicon into a functioning product. Therefore, reliance on the PRC for ATP creates vulnerabilities. As advanced ATP becomes increasingly important economically and technologically—as a way to increase chip performance as "bleeding-edge" chips begin to run into physical size limitations—US-Taiwan cooperation in reshoring ATP and developing advanced onshore capabilities is a prime area for cooperation.

Moreover, while the PRC's investments into leading-edge semiconductor manufacturing have largely fallen short, the country has made such strides in the legacy semiconductor space that worries are being raised about overcapacity—a problem that has led to the complete destruction of non-Red supply chains in other sectors such as solar panels. While overcapacity has not spread to the entire legacy chip market, it is clear that the PRC has advanced significantly in this sector and is now a meaningful global competitor. Given the economic importance of legacy chips (evidenced by the massive costs associated with their supply chain disruption during the COVID pandemic), the security and privacy risks that could be associated with PRC-made legacy chips embedded in consumer products, and the key role of legacy chips in Taiwan's overall semiconductor ecosystem, it is clear that preserving non-Red legacy chip supply chains is also a key priority.

While Taiwan has maintained a leading, central role in semiconductor supply chains—despite the PRC's influence in specific stages—the drone sector is fundamentally different. The dominance of PRC firms, particularly DJI (大疆創新), means that the establishment of a non-Red drone supply chain will require a much more expansive effort to scale production within Taiwan, claw back market share, maintain cost competitiveness, and achieve innovative breakthroughs. The United States has unveiled a number of measures to restrict the importation of PRC drones—and faces challenges in ensuring that beneficial drone uses are not disrupted by these bans. The upshot is that the United States will soon have a large commercial drone market that is open to new entrants—potentially including the rapidly-expanding Taiwanese drone industry. Ensuring that US policy promotes market access for these new entrants—while simultaneously ensuring that entrants' production is not reliant on PRC-manufactured components—would go a long way toward fostering a non-Red drone supply chain.

In the military drone space, the Defense Innovation Unit's Blue UAS Cleared List provides another obvious opportunity for Taiwanese firms seeking to establish non-Red supply chains for the booming domestic and export markets. While PRC drones and components have made their way to both sides of the Russia-Ukraine war, Taiwan's support for Ukraine also provides an opportunity for the two countries to pursue innovation, drawing on Ukraine's wartime experience

and industrial cooperation. Given the continued deepening of Russia-China defense industrial cooperation, particularly in drones, Ukraine is one of the few countries more incentivized to support the creation of a non-Red drone supply chain than Taiwan.

Policy Steps to Promote Cooperation

To effectively progress toward non-Red supply chains, several macro- and micro-level policies enhancing US-Taiwan technology cooperation are necessary. First and foremost, a trade deal that sets the tariff rate as low as possible will improve the economic viability of continued linkages between Taiwanese and US supply chains. While persistent US tariffs on key economic partners are disruptive and regrettable, Taiwan must recognize that the Trump Administration is intractable on this subject—and will need to maintain its flexibility to compromise on key domestic non-tariff barriers to mitigate the impacts of US tariffs on the overall economic relationship. Moreover, in light of the Trump Administration's sectoral exemptions on duties for a large proportion of imports from Taiwan, Taipei may seek further exemptions in exchange for efforts to establish non-Red supply chains in critical industries.

Investment commitments have emerged as central components of the deals announced between the Trump Administration and other trade partners. Taiwan should similarly seek to leverage investment commitments to accomplish shared policy goals. While the topline magnitude of an investment commitment will likely matter more politically to the Trump Administration than the specific terms, targeted investments could play a critical role in building out non-Red supply chains—whether by allowing for increased production of critical inputs, opening up access for Taiwanese companies to the Blue UAS list, or addressing specific chokepoints in the semiconductor supply chain. The inherently greater role for the Taiwanese government in shaping these investments provides a unique opportunity to achieve industrial policy goals, and the Lai Administration should therefore ensure that the Ministry of Economic Affairs (MOEA, 經濟部), NSTC, and other stakeholders develop a priority list of potential investments for Taiwanese government negotiators. Such a list should include information on the investments' strategic significance to the United States. This will allow negotiators to overcome any investment-specific roadblocks—such as obstacles related to obtaining permits (a persistent challenge for the semiconductor industry given the major investments and already long timelines needed to establish a single fab), the Committee on Foreign Investment in the United States (CFIUS), or others.

However, even if these investments are announced, another key obstacle must be overcome to ensure that Taiwanese investments into the United States can be cost-competitive: double taxation. Taiwan remains the largest US trading partner that lacks a formal double taxation agreement, meaning that Taiwanese companies face a significant additional tax burden. While US Congressional politics are never simple—particularly when it comes to Taiwan—the Taiwanese government has emphasized to the Trump Administration the importance of concluding such an agreement. Indeed, a measure to eliminate double taxation passed the US House of Representatives by a 423-1 margin this year. The Trump Administration should encourage the US Senate to pass the House bill immediately after the finalization of any trade deal.

Besides these broad steps, sector-specific measures must also be implemented. In particular, mapping of the relevant supply chains is critical. While this will ultimately require information-sharing from the private sector, examining customs data can provide a first indication of where chokepoints or vulnerabilities might exist. Extending this process down through various layers of component suppliers is complicated but necessary in order to foster non-Red supply chains rather than just non-Red primary suppliers. Sector-specific R&D funding—perhaps stemming from NSTC or US National Lab funding—to address specific areas in which PRC firms maintain a competitive advantage would also be beneficial. For the semiconductor industry, access to remaining *CHIPS Act* funds could facilitate investments smaller than those that are fab-scale—for instance, in advanced ATP or production of critical inputs. In the drone space, ensuring Taiwanese firms have access to the Blue UAS list is the clear priority.

To ensure that non-Red supply chains become an industrial reality rather than a political slogan, it is also wise to start small: working first to remove reliance on the PRC in a limited number of priority sectors, rather than attempting a comprehensive, wide-reaching purge. The complexity of global supply chains means that reshaping them—and in particular removing PRC linkages in an era in which PRC manufacturing firms have become increasingly internationalized—is commensurately complex. The need for continued political attention to ensure that vulnerabilities are not just shuffled around, but solved, means that there is an inherent limit to how broadly Lai's vision can be im-

plemented. Moreover, starting with a small number of sectors whose concerns can be effectively managed will increase private sector buy-in in future efforts—and will also provide lessons and learnings that can allow the process to improve over time.

The main point: President Lai Ching-te has outlined a broad vision for "non-Red supply chains." Taiwan-US cooperation and investment in the drone and semiconductor sectors, coupled with requisite policy support, could effectively operationalize this vision and mitigate the risks emanating from the PRC.

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Learning from Tsai: Energy Policy Lessons for the Lai Administration

By: Nils Peterson

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Taiwan ranked 52nd out of 61 countries in the Climate Change Performance Index (CCPI)—an annual assessment that evaluates and compares national climate change mitigation efforts—at the end of 2016. Nearly a decade later, Taiwan remained near the bottom, placing 60th out of 67 countries in the 2025 CCPI.

This sustained poor performance raises important questions about the effectiveness of former President Tsai Ing-wen's (蔡英文) climate policies during her tenure in office from 2016 to 2024. It also prompts an analysis of the obstacles to Taiwan's energy transition facing current President Lai Ching-te (賴清德). These questions include: 1) How effectively has the Republic of China (ROC) government supported the country's move to renewable energy since 2016? And 2) How can the Lai Administration address the remaining unresolved challenges over the next three years?

Evaluation of the Tsai Administration's Energy Policy

In 2018, the Tsai Administration announced Taiwan's renewable energy goal for 2025, aiming to source 20 percent of its energy from renewables, 30 percent from coal, and 50 percent from low-carbon natural gas—an objective commonly known as Taiwan's "20-30-50 formula." Tsai built upon this commitment in April 2021 when she restated that her administration's long-term renewable energy policy was to achieve net-zero carbon emissions by 2050. In March 2022, the ROC government released its action plan in a report titled *Taiwan's Pathway to Net-Zero Emissions in 2050.*

The Tsai Administration introduced a series of legal reforms to pursue this renewable energy goal. It amended the *Electricity Act* (電業法) three times as well as the *Greenhouse Gas Reduction and Management Act* (溫室氣體減量及管理法), now called the *Climate Change Response Act* (氣候變遷因應法). The *Electricity Act* amendments allowed direct sales of green energy to users as part of the government's efforts to "promote [the] liberalization of the green energy market." This regulatory framework allowed major transnational companies like Google to purchase renewable energy for their business operations, such as data centers, while still investing in the Taiwanese economy. The amending of the *Greenhouse Gas Reduction and Management Act* created a carbon pricing system with both levies and fees. This change provided additional financial incentives across the energy production and usage supply chain to minimize the use of carbon-based energy sources in favor of green energy alternatives. Taken together, the amendments to the *Electricity Act* and the *Greenhouse Gas Reduction and Management Act* offered financial incentives for businesses to use green energy, while penalizing carbon-heavy options and establishing a conducive regulatory environment.

However, despite creating a favorable climate for renewable energy, the Tsai Administration failed to achieve its 20-30-50 formula by the end of its term in office. The graph below demonstrates that a lack of renewable energy and overreliance on coal throughout Tsai's tenure contributed to this unsatisfactory outcome.

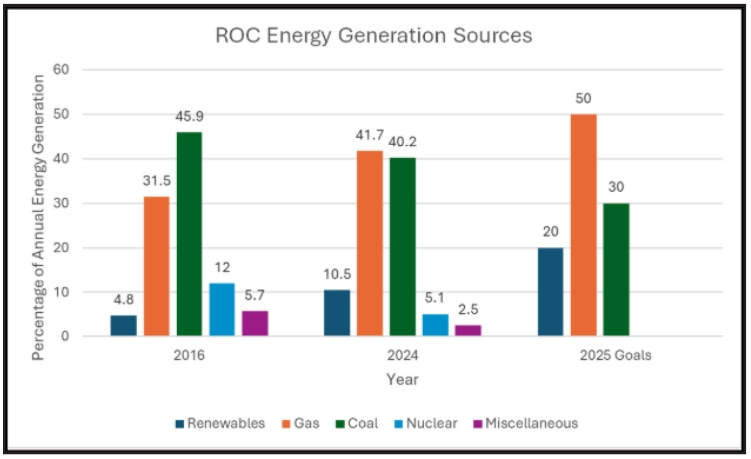

Figure 1: Graph showing changes in Taiwan's actual energy generation sources between 2016 and 2024, compared to the Tsai Administration's targeted 20-30-50 formula for 2025. (Figure source: ROC Ministry of Economic Affairs, Energy Administration)

Reasons for Failure

The Tsai Administration fell short of its energy objectives for two primary reasons: insufficient renewable energy generation capacity and growing domestic energy needs. The Tsai-led Democratic Progressive Party (DPP, 民進黨) controlled the executive and unicameral legislative branches throughout her tenure as president. As described above, the DPP used this power to amend the *Electricity Act* and the *Climate Change Response Act*. Despite these successes, Taiwan's renewable energy generation capacity did not improve quickly enough to meet stated goals (see Figure 1). Additionally, Taiwan's energy demand growth also detracted from the Tsai Administration's ability to reach its energy goals. Taiwan has averaged 0.41 percent growth in domestic energy consumption every year since 2003. In 2024, Taiwan's total energy demand was 3.35 percent higher than it was in 2016, when Tsai first assumed office. While this increase may appear modest, growing energy demand has nevertheless forced an even greater emphasis on the use of renewables to meet the Tsai Administration's energy objectives. This reduced generation capacity, combined with rising energy demand, has raised pressure on existing efforts to meet the government's energy policy priorities.

Two secondary reasons that the Tsai Administration failed to reach its stated energy objectives were limited foreign investment and Taiwan's exclusion from international institutions. Taiwan needs to double its 2024 renewable energy generation capacity to reach its 20 percent renewables goal by 2025, as demonstrated by the graph above. One possible solution is to construct more wind farms. Of the 370 wind farm sites that the Taiwanese government is considering for construction, the majority could be expected to return a profit if optimally developed. Attracting higher levels of foreign investment to offset the costs of wind site development could be one way to address this issue.

In addition to foreign investment and energy supply concerns, Taiwan's diplomatic isolation from international energy institutions has hindered its ability to transition more effectively to renewable energy. As analysts Evan Feigenbaum and Jen-yi Hou (侯仁義) have noted, Taiwan is not a member of the Organization for Economic Cooperation and Development (OECD), and therefore is not associated with the International Energy Agency (IEA). Moreover, the IEA hosts the Clean Energy Ministerial Secretariat and Energy Efficiency Hub, a platform for global collaboration on data-sharing and technological development initiatives. The inability of Taiwan to benefit from this forum—once again due to the PRC's opposition to Taiwan's participation in prominent multilateral organizations on grounds of the "One-China Principle"—hinders its pursuit of the 20-30-50 objective.

Lessons for the Lai Administration

The Lai Administration inherited this set of policy successes and challenges upon taking office in May 2024. Lai faces two potential major energy policy issues in the remainder of his tenure: rising electricity demand and political friction with the Kuomintang (KMT, 國民黨) over the role of nuclear power.

Taiwan's electricity demand is set to grow much more quickly over the coming decade than the past twenty-year average of 0.41 percent annual growth. The Ministry of Economic Affairs (MOEA, 經濟部) predicts that the rise of artificial intelligence-related technologies that use a large quantity of energy, such as data centers, will drive a 2.8 percent increase in energy consumption every year through 2033. This means that the Lai Administration will face even more acute pressures to meet the ROC's renewable energy objectives compared to the Tsai Administration.

However, the DPP no longer controls the legislative branch, as it did during the Tsai Administration. The KMT has allied with the Taiwan People's Party (TPP, 民眾黨) to control the Legislative Yuan (立法院) since the start of Lai's presidency. The failure of the summer 2025 DPP-aligned civic group electoral recall campaigns to remove a single KMT legislator means that Lai must still reckon with a KMT- and TPP-aligned legislative branch when advancing any legislation. While the KMT broadly accepts the need to transition to renewable energy, it embraced the view that nuclear power was a necessary component of Taiwan's energy supply in the 2024 presidential election. As the anti-nuclear movement is a core facet of the DPP's political charter, the opposing views of the KMT and DPP on nuclear power may lead to increased gridlock on energy policy.

Lai should learn from the Tsai Administration and prepare to generate joint public-private investment in constructing renewable energy generation and storage capabilities. In their paper, Feigenbaum and Hou propose two options for Taiwan's energy storage. First, Taiwan can look toward megapack solutions that focus on providing storage for commercial renewable energy sources to meet periods of peak electrical demand. Successful examples around the world include South Australia's Hornsdale Power Reserve and California's Moss Landing project. Second, Taiwan could draw inspiration from Australia by adopting the concept of virtual batteries. This approach allows individuals to lease small portions of their battery storage to the grid

in times of intensified energy demand. Expanding storage capacity also helps mitigate the volatility of renewable energy by, for example, enabling the storage of excess energy produced on windy days for use during periods of low wind activity. These two approaches offer practical opportunities for the Lai Administration to collaborate with the private sector along the path to renewable energy transition.

The main point: The Tsai Administration set an ambitious "20-30-50 formula" for Taiwan's energy sector by 2025. Yet, upon leaving office in 2024, it had not positioned Taiwan to achieve this objective in the year ahead, primarily due to a lack of renewable energy generation capacity and intensifying energy demand. The Lai Administration now faces a challenging political environment concerning two potential major energy policy issues: rising electricity demand and political friction with the KMT over the role of nuclear power. Lai should learn from the Tsai Administration's energy policy failures and prepare to generate joint public-private investment in constructing renewable energy generation and storage capabilities.

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Sharpening the Porcupine's Quills: Politically Viable Strategies to Increase Taiwan's Defense Spending

By: Sean Tan

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Explosions of missile strikes, civilian screams and bloody shores — this is the grim scenario that Chinese propaganda wishes to relay to the Taiwanese public, one in which "peaceful reunification" is the only path to avoid annihilation. Many Taiwanese fear that they are woefully unprepared for such a situation; three in ten residents express "no confidence" in their armed forces, while fewer than half that number report "strong confidence."

Next year, Taiwan aims to allocate NTD 949.5 billion (USD 31.27 billion) to defense, or 3.32 percent of its GDP. While such a figure is a marked improvement from the highly inadequate expenditure of the 2010s, it not only remains below that of other nations confronting similar existential threats—including Poland and Estonia—but is also dwarfed eight times over by China's budget. Addressing this gargantuan disparity will require a three-pronged strategy: improving the military's public image, surmounting fiscal limitations, and dispelling doubts about the effectiveness of defense spending.

Reimagining the Military's Identity

The military itself remains an emblem of internal occupation to many in Taiwan. After the Kuomintang (KMT, 國民黨) gained control of Taiwan, Chiang Kai-shek (蔣介石) used the military to suppress the Taiwanese population, massacring an estimated 30,000 Taiwanese during the February 28 Incident of 1947 and more throughout the White Terror Period from 1949 to 1992.

Although public sentiment regarding the armed forces has mellowed since Taiwan's democratization, lingering mistrust continues to sap public appetite to raise defense spending. In the fragile aftermath of political transition, fears over a potential coup have led successive presidents to tread cautiously and avoid sweeping reforms that might rebrand the institution with a distinct Taiwanese identity. Even today, Taiwan's officer corps is disproportionately composed of descendants of mainland émigrés and dozens of soldiers continue to have Chinese residency permits.

To resolutely sever ties with its authoritarian legacy, Taiwan's military needs to eradicate its image as an untrustworthy black box. For instance, the government could allow the Legislative Yuan to scrutinise the promotions of senior officers—as the Senate Armed Services Committee does in America—since this responsibility currently lies solely with the Ministry of National Defense (MND, 國防部) and the president. To allow greater public oversight and enhance public engagement, Taipei should simultaneously facilitate broader access to military installations for students and journalists, while instituting formal civil-military exchange programs to embed academics inside operational units. Although such transformative reforms may encounter resistance from a military establishment accustomed to considerable autonomy, the United States' intensifying demands for such measures presents an invaluable opportunity to counter such opposition.

Furthermore, Taiwan's armed forces could build further trust with the public by putting forward a more uniquely Taiwanese persona. For instance, indigenous symbols such as the Formosan black bear or the plum blossom could be used in place of Chiang Kai-shek iconography, and military institutions could be named after local resistance heroes and democratic martyrs. In addition, the Taiwanese military could better reflect Taiwan's pluralism by translating outreach efforts into local languages—including Hakka and Taiwanese Hok-

kien— and by creating leadership pathways for soldiers from underrepresented demographics through specialised programs and financial grants. These might be targeted at Taiwan's indigenous peoples in particular, who remain chronically absent from senior roles despite comprising 60 percent of some military units, even while representing only 3 percent of Taiwan's population.

Unlocking Taiwan's Fiscal Potential

The second impediment to expanding Taiwan's defense funding lies in its constrained fiscal bandwidth. The island operates an exceptionally austere state apparatus, with total government outlays comprising a mere 13.7 percent of GDP, which is drastically lower than the OECD average of 49.3 percent. Such fiscal minimalism has become increasingly untenable amid other mounting economic challenges, including a rapidly aging population and global trade disruptions caused by President Donald Trump's tariff regime.

Nevertheless, polling data reveals latent political elasticity in the public's stance toward defense spending. While these polls indicate that reallocating expenditure from other sectors might be relatively politically unviable, some 48.7 percent of respondents were amenable to tax increases for greater defense spending, while 45.8 percent expressed opposition. To tip public opinion in favor of greater defense spending, Taiwan should eschew approaches that are more politically fraught, such as a broad-based goods-and-services tax hike, in favor of targeting those best positioned to contribute. Additionally, policymakers could mitigate opposition by framing these levies as patriotic contributions to a national defense fund, echoing the rhetoric the American government used to successfully popularize its "Victory Loan" bond program during World War Two.

One approach would be to marginally elevate the corporate tax rate by one to two percentage points above the existing 20 percent threshold. This could generate NTD 15 to 30 billion (USD 494 million to 988 million) in additional revenue while preserving Taiwan's international competitiveness, as the resulting duties would remain below those of regional counterparts—these include South Korea and Japan, whose rates stand at 24 and 30 percent respectively. Structural advantages, such as Taiwan's robust legal infrastructure and its geographic proximity to Asia's financial epicenters, would also likely mitigate any capital flight due to these slight increases in corporate tax.

To further increase government funds, Taipei could also increase taxation on more affluent populations through heightened inheritance and luxury levies, and the enactment of minute capital gains taxes on dividends. While the latter may raise concerns that an economic crisis similar to the 2015 market backlash might occur, the current predominance of domestic investors within Taiwan's stock market—as evidenced by Taiwan's meagre FDI-to-GDP ratio of 18.9 percent—suggests that the resulting volatility would likely be limited. Opposition from the financial elite is also likely to be tempered, as many belong to family-dominated conglomerates whose financial influence is inextricably linked to the domestic economy. Offshoring capital would not only tarnish their businesses' brand images, but also result in the loss of exclusive investment channels and influential board appointments.

Transforming Budgets into Bulwarks

Skepticism that defense expenditure is wasteful, and potentially even counterproductive, has also become so deeply ingrained that it now permeates the highest echelons of the legislature. Earlier this year, the KMT denounced portions of the defense budget as "excessive," slashing NTD 8.4 billion (USD 277 million) and freezing an additional NTD 90 billion (USD 2.96 billion), despite the fact that these funds were earmarked for essential operational needs, from pilot training to aircraft fuel. A sizable proportion of voters also fear that escalating military outlays could incite public anxiety, deterring foreign investment and bolstering support for diplomatic reunification with China to avert a conflict perceived to be "unwinnable." Moreover, with 61 percent of Taiwanese believing that a Chinese invasion is improbable within the next five years, public concerns that raising defense spending might unnecessarily provoke Beijing into military confrontation persist.

Compounding this reluctance is mounting frustration with America over its failure to deliver on defense procurement commitments. The current backlog of US military equipment amounts to a staggering USD 21.5 billion, leading many taxpayers to question the efficacy of increased defense spending and eroding political capital among pro-defense legislators. For instance, Taiwan had planned to receive 40 M109A6 self-propelled howitzers by the end of 2025, yet only six are expected to arrive in 2026. This predicament is also mirrored in the planned acquisitions of F-16V fighter jets, Abrams tanks, anti-tank missile systems, amongst other items.

Taipei should therefore flip this narrative on its head, emphasizing that insufficient defense spending would embolden China to consider an invasion of Taiwan. Historical precedent offers a compelling illustration:

during the 1996 Taiwan Strait crisis, the deployment of two American naval battle groups successfully defused Chinese aggression rather than inflaming it. Embracing this argument would be especially effective given Trump's vacillations on US commitment to Taiwan's defense and persistent calls for the island to significantly boost its military budget, whereas America would be more likely to support Taiwan if it demonstrated a strong will to fight.

Addressing delays in Taiwan's defense procurement poses a more formidable challenge, especially as the United States' preoccupation with Ukraine limits prospects for prioritizing Taiwan in current American arms sales. As a result, Taiwan's fiscal resources could instead be redirected to nurture a more robust domestic defense-industrial complex—an emerging sector whose prioritization of asymmetric warfare capabilities, including its rapid development of anti-ship missiles and unmanned surface vehicles, may prove paramount. This strategy would be most effective if Taiwan follows Ukraine's example by emphasizing drone technologies, while also focusing on non-cutting-edge equipment such as small arms and landmines, where upholding US technological superiority is less critical. It would also likely be politically popular since it would stimulate vast employment across a broad range of skill levels, encompassing a variety of fields from basic manufacturing to sophisticated research and development.

The main point: From operating just four weathered submarines to facing a severe shortage of conscript trainers, Taiwan must urgently bolster its deterrent to command the respect of China, its allies, and its own people. This can be achieved through a three-prong approach: improving the military's public image, surmounting fiscal limitations, and dispelling doubts about the effectiveness of defense expenditure.

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