
Conclusion

Taiwan and China each have compelling reasons to pursue a cross-strait deepening program that includes economic normalization and goes beyond it to match the degree of liberalization occurring in other regional agreements. Cross-strait economic relations have expanded at a fast pace for decades without a comprehensive bilateral agreement, but that approach is increasingly antiquated, especially from Taiwan's perspective. The MOUs negotiated in recent years have gotten more material. The ECFA signed on June 29, 2010, supplants that piecemeal approach with a hefty initial set of openings and a comprehensive roadmap for moving further. For Taiwan the agreement is key to maintaining parity with regional peers, while for China it is a step toward winning Taiwanese hearts and minds while turning the page on vestiges of the Cold War past. The United States was respectful of the complexity of the cross-strait discussions that led to the ECFA, and helpfully refrained from injecting its interests into the conversation. Since the signing, the United States has been supportive of these developments, since they generally promote a more peaceful and prosperous outlook for the two sides.

A number of policy conclusions relevant to this deepening can be drawn from the quantitative and qualitative economic analysis in the preceding chapters. While the ECFA and early harvest round of trade-opening commitments concluded in June 2010 provide a concrete starting point, the final shape of cross-strait economic relations will take years to negotiate. Negotiation of the main body of an FTA has yet to begin. Therefore these conclusions are relevant only to the current moment, and will need to be revisited frequently to reflect the fast-moving pace of developments to come. This final chapter offers concluding observations for Taiwan, China, and the United States, in turn.

Taiwan

The Economic Cooperation Framework Agreement—Just a Flat Field, Not a Cathedral

More comprehensive cross-strait economic liberalization is critical to maintain Taiwan's economic competitiveness in the years ahead. Proponents and opponents alike should recognize, however, that the ECFA is just a step toward a level playing field with regional competitors that have pushed beyond MFN status to a WTO+ relationship with China, as well as other economies concluding bilateral FTAs with China. Many of the economic competitiveness benefits Taiwan achieves in the ECFA process arise from dismantling its own unilateral non-WTO-compliant restrictions on trade with China, and thereby achieving a level playing field with the other 151 members of the global trade organization.

This bears repeating: *the ECFA means a level playing field only for Taiwan*. It contributes to significantly higher GDP in 2020 versus business as usual, but it does not necessarily improve Taiwan's comparative advantage vis-à-vis its competitors, all of which will also see gains from deepening economic intercourse with China.

While the lack of liberalized economic relations with the mainland is a definite negative for Taiwan, achieving parity with ASEAN does not by itself amount to an economic strategy to secure Taiwan's future prosperity. The ECFA, or even the ECFA plus ASEAN+3, is not the solution to Taiwan's long-term prosperity. Neither is an FTA with the United States. Rather, it is just a leveling of the playing field. The question is what Taiwan *does* on that playing field once it is leveled.

The economic gains our model projects for Taiwan are predicated on historical levels of productivity in Taiwanese industries. To fulfill these projections, Taiwan must sustain that productivity.¹ Whether to pursue parity with regional competitors through the ECFA is truly the easy question for Taiwan; what strategy for national competitiveness to build on the ECFA foundation is truly the hard question. We strongly recommend that Taiwan's leaders and citizens look beyond the question of matching ASEAN's terms of economic engagement with China through the ECFA and move urgently to the other challenges involved with nurturing Taiwan's future competitiveness.

A variety of national competitiveness initiatives have been tested in Taiwan over the past two decades. In the 1990s, Taiwan aspired to be an Asia-Pacific "regional operations center," taking advantage of its Chinese language, superior legal institutions, and highly skilled population to be a headquarters domicile for firms focused on the greater China region, in a

1. Productivity parameters are embedded in the macroeconomic data fed into the model; see the appendices for more detail.

manner similar to Hong Kong. But at the time, restrictions on travel, labor, and investment flows across the strait made this impossible, and up until now the prospect of future political difficulties has continued to hang over the relationship, making it more risky for international investors. The disadvantageous tariff treatment and other inferiorities arising from failure to match preferential arrangement terms would make these concerns still more acute.

Lately, Taiwan's national innovation institutions such as the Industrial Technology Research Institute (ITRI)—responsible for incubating some of Taiwan's greatest firms in the past—have emphasized a sectoral focus for Taiwan's competitiveness. The ITRI is focusing on information and communications, materials and nanotechnologies, biomedicine, advanced manufacturing, and energy/environment. However, these same sectors are an industrial policy focus in other economies as well, including China, Korea, Singapore, and Japan. The ITRI is concerned about the effect of ASEAN plus China on Taiwan's "network of competition," as it would create tariff disadvantages for some areas of communications, product trade, petrochemicals, and machine tools. More than tariffs, the ITRI is concerned about standards regimes for light emitting diodes (LEDs), batteries, appliances, communications devices, data storage, and other products, as well as verification and certification of testing labs and mutual recognition of pharmaceuticals.² The ECFA prescribes "joint industrial cooperation" with China, which is intended to draw the parties close together on technical industry coordination matters such as these. Taiwan recognizes that there may be a thin line, however, between advantageous industrial cooperation and joint industrial policy machinations that provoke complaints from third parties, including the United States.

Cross-Strait versus Cross-Asia

It has been argued that the best thing about the ECFA is the prospect of Taiwan's inclusion in broader plurilateral liberalization beyond it. Politically, Taiwan's freedom to negotiate with others in the region may be important; in economic terms, this study suggests that the benefits to Taiwan lie in normalizing an abnormal cross-strait economic relationship more than further liberalizing other relationships. Taiwan interacts with the rest of the WTO membership on an MFN basis; it is the relationship with China that is distorted by policy interventions to block imports and investment, and hence liberalizing that relationship stands to deliver the greatest benefit. Not only is China the facet of Taiwan's external engagement that is distorted, but it is also where Taiwan stands to gain by far the greatest growth in the years ahead.

2. Authors' interviews with senior ITRI staff, April 2009.

Following the ECFA with inclusion in Asia-wide WTO+ liberalization does provide some economic benefits for Taiwan. In welfare terms, these are small compared to the cross-strait gains. Probably the greatest benefit accruing to Taiwan from inclusion in regional schemes would be the definitive evidence that Taiwan was “normal” and hence as attractive a place from which to serve the “Chinese” marketplace as any other. If these Asian regimes move into the role of setting standards and otherwise providing for the “soft tissue” of international trade, then having a seat in those regimes will become still more important for Taiwan, although this is a few years off.

Taiwan officials and others trying to be supportive of Taiwanese interests should continue to be careful on this issue. If Beijing really wants to demonstrate a desire to be accommodating of the economic aspirations of the Taiwanese people, it will make clear that having concluded an opening agreement with Taiwan itself, it has no objection to others doing so. This appears to be Beijing’s intention, and what other economies in the region expect; and indeed Taiwan and Singapore have, as predicted, begun consultations to that end without eliciting complaints from Beijing. With the ECFA now in place, even if Taiwan proceeds to join future regionwide agreements its prosperity will still rely on a new competitiveness strategy to build on that opening, rather than on the liberalization per se. In the past, Taiwan had only to open a new area of external economic relations and private firms would rush to take advantage. At today’s more advanced level of development, Taiwan must do more than just selectively get out of the way; government must proactively step in and deliver the leadership needed to revitalize the sense of future economic achievement.

Prospects with the United States

In assessing the prospects for a US-Taiwan FTA six years ago, Lardy and Rosen (2004) concluded that liberalizing Taiwan’s trade with the United States would not provide much benefit, given the relatively free nature of that relationship already. The authors called for cross-strait normalization instead.

The same economic analysis applies today. Taiwan will generate little immediate benefit from deepening trade ties with the United States because US-Taiwan trade is already predominantly free (and areas that are not, like apparel, would pull Taiwan in a backward direction). It would be a distraction for Taiwan to get fixated on the prospect of post-ECFA FTA negotiations with the United States. This is particularly true given a backlog on US trade policy action in Asia (and globally).

That said, as argued in the previous chapter, the momentum of ASEAN plus China followed by the ECFA may well serve as a wakeup call to the United States and impel its return to Asian economic liberalization. Post-

ECFA, Taiwan will have better market access in China than the United States does. There will be calls in the United States to pursue parity with the WTO+ border barriers being negotiated in Asia, and Taiwan should be prepared to discuss participation in Asian plurilateral agreements of interest to the United States. In addition, the logic of a US-Taiwan FTA is more compelling today than it was in the past, now that Taiwan has addressed cross-strait abnormalities and has a better prospect of playing a more important role as a Greater China operations center.

Easy on the No's

Taiwan President Ma Ying-jeou's government declared "three no's" for the cross-strait economic negotiations: no sovereignty issues would be discussed, no labor opening would be entertained, and there would be no agriculture opening. This is a simple way to fix an idea in the public imagination, and the sovereignty point is straightforward. But such blanket exclusions may not be appropriate for areas of economic activity.

In the case of agriculture, Taiwan Council of Agriculture Chairman Chen Wu-hsiung made clear that the sector would not be included in talks. "Since the issues will not be discussed, the ECFA will have no impact on Taiwanese farmers at all," he said.³ In our quantitative results, Taiwan's agriculture and food sectors are actually a mixed bag: we do see shrinkage in output in some food sectors under the ECFA scenario, but we see growth in others. This is despite the fact that we excluded agriculture and food from liberalization assumptions as agreed upon in the ECFA; effects arise due to general changes in GDP size and equilibrium effects despite their exclusion, and as a result of China's unilateral opening of some food sectors. Moreover, these sectors are impacted under the non-ECFA scenario as well: standing still or standing apart from opening processes is certainly no guarantee of higher output in the future.

Agriculture as it exists in Taiwan today, as in most high-tech economies, is not an area of obvious comparative advantage. And yet, faced with diminishing marginal productivity gains from traditional inputs and techniques, producing high-quality food efficiently and dependably is becoming a higher-tech industry all the time. There is a strong case to be made that Taiwanese farmers are in a position to gain from more open trade with China. There is in actuality already some amount of agriculture trade between the two, though not so much in terms of foodstuffs on the Taiwanese import side. China suffers from severe challenges in regulating and insuring a healthy, pollutant-free food chain, and the mainland market for higher-value organic food products is booming. Taiwan's food

3. "Agriculture Issues Not on ECFA Agenda," *Taiwan News*, January 4, 2010. www.etaiwannews.com/etn/news_content.php?id=1147128&lang=eng_news&cate_img=83.jpg&cate_rss=news_Politics_TAIWAN&pg=4 (accessed on September 15, 2010).

product standards are excellent, and “Made in Taiwan” is capable of attracting premium pricing and building a market in China vastly greater than the home market. Already, many higher-end food enterprises in eastern China are Taiwan invested and managed, and Taiwanese farmers can benefit from China’s consumer market growth in the same way that farmers in New Zealand, Australia, Chile, and elsewhere have. In terms of concerns about reciprocal market access for grains and crops where scale is an issue, Taiwan is not obligated to forgo high-standards regimes in a cross-strait agreement.

In terms of labor markets, in agriculture, there has already been some modest flexibility: those few investments from China into Taiwan to date obviously require staffing by the investor, and with two-way investment opening already concluded under an MOU, this will expand. Moreover, there is some discussion of permitting higher-skilled labor from China to contribute to businesses in Taiwan, and also of creating bonded assembly zones where low-cost labor from China would be permitted in order to keep Taiwanese manufacturing in Taiwan. A flexible mindset on issues including labor can improve the outcomes for Taiwan.

China

Focus on the Economics

Officials in Beijing generally downplayed concerns about the details of the ECFA, instead focusing on key principles such as adherence to existing WTO commitments. This gave rise to the view in Taiwan that the undertaking is not essentially economic, which is unhelpful. The benefits to Taiwan arise more from dismantling protection at home than in China, and moderate pressure from Beijing not to exclude sensitive sectors (like agriculture) could be helpful to Taiwanese negotiators in the future as they confront domestic special vested interests if there is some requirement to do so. In trade negotiating parlance, the term *gaiatsu* has been borrowed from the Japanese to describe using pressure from abroad to justify needed changes at home. If such pressure is identified as having a legitimate marketplace basis, rather than a purely political basis, it could help reset Taiwanese perceptions about the essential purpose of the agreement.

One Eye across the Pacific

Technically, China considers the ECFA an internal matter, not a matter of bilateral external affairs, much less an undertaking with trans-Pacific considerations. Practically, Beijing is mindful that US anxieties about closer

cross-strait relations could flare up and complicate matters, potentially slowing momentum, if US sensitivities are neglected. The United States has been mildly supportive of cross-strait economic deepening to date. As former American Institute in Taiwan Director Stephen Young said in mid-2009, “[t]he expansion of economic ties is consistent with our goals of helping to foster Taiwan’s security while avoiding unnecessary cross-strait friction. The policies also make Taiwan more attractive as a destination for U.S. investment.”⁴

While the United States has not openly communicated detailed preferences with regard to cross-strait deepening at this point, China can best ensure continued US support for the process by ensuring that the ECFA is consistent with WTO standards for preferential trade agreements and by continuing to stand out of the way of Taiwan’s participation in other economic liberalization regimes, whether bilateral or plurilateral. Given US priorities, this could include Taiwan’s inclusion in future TPPA discussions. A US-Taiwan trade agreement was not a first-order priority for the United States in 2010, but as Taiwan deepens its connections to China this may evolve.

The United States

Economic Deepening in Taiwan’s Interest Is Also in the Interest of the United States

The United States is better off with a prosperous Taiwan that can afford to chart its own future course. Pursuit of that prosperity requires that Taiwan liberalize its economic relations with China in step with its regional peers. Standing still is not an option for Taiwan while all the economies around it pursue more dynamic economic links with China. Therefore the United States should welcome a cross-strait economic agreement that supports Taiwan’s economic interests without undermining other imperatives. While political and security concerns may arise, these are not more acute after cross-strait deepening than they are in the event of business as usual, and they should be addressed with appropriate safeguards rather than blanket Cold War prohibitions on Chinese exports and investment in Taiwan. On the other hand, there are specific terms in the ECFA, notably “joint industrial cooperation,” that may be a source of concern. The United States should clarify that such objectives, and the ECFA as a whole, are WTO-consistent and procompetitive, rather than an invitation to collusion to take global market share.

4. “AIT Director Calls for End to Agricultural Trade Dispute,” *Taiwan Today*, June 5, 2009. www.taiwantoday.tw/fp.asp?xItem=52148&CtNode=427 (accessed on September 15, 2010).

Follow Suit Plurilaterally and Bilaterally

Resolving remaining economic distortions between Taiwan and China is critical to Taiwan's prosperity and can lessen the prospect of security tensions in the region if managed well. But the fact that even Taiwan and China have a forward-leaning trade policy agenda underscores the relative absence of the United States from Asian economic deepening. Five years ago, the notion that Taiwan could undertake an FTA with Beijing before doing so with Washington seemed fanciful. Now the first stage of that has come to pass. As has been pointed out, if the United States does not have a trade policy for Asia, it does not really have an Asia policy.

President Obama took steps to remedy this state of affairs in 2009, opening the way to deeper involvement with ASEAN and invigorating discussions of participation in the TPPA. The bilateral agreement with South Korea signed in 2007 will be submitted for ratification in 2010. Given the difficulty of making room for trade opening in general with a crowded policy agenda, and given the limited benefits possible in US-Taiwan trade deepening, Taiwan's involvement in a plurilateral undertaking seems like a first-best notion. However, as Taiwan parlays its ECFA opening into a position of new relevance to the greater China marketplace, the logic of a US-Taiwan FTA will likely grow.

For now, the United States should reopen the lapsed TIFA talks with Taiwan at an early opportunity. These discussions can facilitate US-Taiwan progress on resolving trade and market access disputes, further preliminary discussions on bilateral investment, and—importantly—assure consultations on the nature of the ECFA's joint industrial cooperation activities and other Taiwan-China initiatives that may raise concerns in Washington.

Economic Policy Concerns

Our model suggests that China-Taiwan economic deepening will have only minor diversionary and other negative effects on the US economy. These diversions will generally reflect China's comparative advantage rather than unfair trade terms for the United States, and in many cases will accrue to US firms manufacturing in China. Nonetheless, the United States will want to take Taiwan's implementation of trade policy commitments all the more seriously in light of displacement of US exports (for instance in textiles, transport equipment, and machinery).

Taiwanese firms may enjoy operating benefits in China that exceed the MFN-level terms extended by China to other WTO partners. For instance, some requirements for Taiwanese financial institutions will be preferential. We are not aware of US firms likely to object to these outcomes, and a reluctance to complicate delicate regional policy dynamics may trump

any US government objections. China is likely to argue that Taiwan will be treated differently because relations with the island are an internal matter, and, indeed, China already maintains a separate designation for firms from Taiwan, Hong Kong, and Macao under its regulatory system. Taiwan may well argue that its firms in many sectors, such as finance, have been in a holding pattern for years to gain full entry to China and should be able to waive time requirements imposed on other firms, such as three years of profitable operations before attaining the right to apply to take deposits in banking. The United States should prepare to respond to these arguments in case these issues arise in a sector of importance.

Finally, the United States must find the time in its busy schedule of domestic and international governmental affairs to consider the China-Taiwan situation in the long sweep of history. China is not politically static; it is evolving rapidly as a polity as well as an economy. The China we deal with today is much more liberal than the totalitarian communist entity we courted to hedge against Russian aspirations three decades ago. We should not lose our conviction that the middle-income China of the future will necessarily employ more politically accountable mechanisms to manage its affairs and balance its divergent social interests. Taiwan's young democracy may end up seeding the mainland with more progressive notions of citizenship if the cultural firewalls maintained across the strait are dismantled along with trade barriers. If this comes to pass, will the United States be remembered as a proponent of Chinese reconciliation, or as a self-interested obstructionist? The answer will profoundly affect American prospects in a future world in which China is a first-order power.

