

Cross-Strait Economic Integration in the Regional Political Economy

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Abstract

The recently signed Economic Cooperation Framework Agreement between Taiwan and China is not only a result of the intensifying economic relationship across the Strait but is also to further secure the connection between the two sides. Taiwan enjoys short-term economic benefits but ECFA favours China's political intentions in the longer term. Moreover, putting cross-Strait economic integration into a regional context, Taiwan is likely to join the current wave of "China-centred" regionalization. China's gravity in regional economic integration has been greatly enhanced subsequent to the recently signed trade agreements with Southeast Asian countries, Hong Kong, Macao and Taiwan. China's expansion of power in East Asia could pose a challenge to the status quo in the region and American interests in particular. How the US responds to China's increasing dominance in the regional economy is critical for the future development of economic integration in East Asia.

Keywords: cross-Strait relation, US-Asia economic relations, regional economic integration in East Asia

JEL classification: F13, F15, F53, F59

1. Introduction

There are two aspects to the evaluation of the progress of economic integration between Taiwan and China. One is the investigation of trade and investment relationships and the other is via the analysis of institutional interactions between the two sides. Over the past two decades, trade and investment relationships between Taiwan and China have been prosperous even though there is no free trade agreement to promote it. The driver behind the closer Taiwan-China economic integration has been mostly based on the business interests of entrepreneurs, each side's national economic development

policy and the global economic situation, rather than any arranged economic cooperative mechanism between Taiwan and China.

The lagging development of institutionalized cross-Strait economic relations has improved since the current Taiwanese President, Ma Ying-jeou 馬英九, took office in 2008. The recent improvement in government-to-government cooperation on cross-Strait economic affairs includes the easing of the RMB-NTD conversion business in Taiwan, cross-Strait securities investment, the ceiling on Mainland-bound investment in Taiwan, the permitting of Mainland capital to invest in Taiwan's stock market, direct flights between the two sides and the opening up of Taiwan to Chinese tourists. Representative of the progress in institutionalized cross-Strait economic relations was the signing of the Economic Cooperation Framework Agreement (ECFA) in June 2010. It was a historical moment because Taiwan and China, who have both claimed themselves to be the only legal government of China and denied formal recognition of each other, committed themselves to trimming tariff and commercial barriers. Although ECFA is a product of intensified cross-Strait economic relations, it also plays an active role in securing the future connection between Taiwan and China. Indeed, the establishment of more measures of economic cooperation across the Strait was not surprising as both sides have vigorously sought to improve relations after the Kuomintang 國民黨 (KMT) regained Taiwan presidency in 2008. Contrary to President Chen Shui-bian 陳水扁's era (2000-2008), where his strong "Taiwan consciousness" was less favoured by China, President Ma's emphasis on Chinese ethnicity and Chinese identity won much of China's applause. With the same "One China" principle¹ in mind, the two sides found room to cooperate, especially in economic affairs.

Until June 2010, the most noticeable measure on ECFA was the early harvest programme which has taken effect since January 1st 2011. According to the ECFA early harvest programme, China will lower tariffs on 539 items, which accounted for 16 per cent of China's total imports from Taiwan in 2009. Meanwhile, Taiwan will lower tariffs on 267 items, which accounted for 11 per cent of Taiwan's total imports from China in 2009. The items that China opens up to Taiwan range from agricultural goods to manufacturing products such as petrochemicals, machinery, transport equipments and textiles. However, Taiwan opens up no agricultural goods to China and the manufacturing items listed in the early harvest programme are quite limited. As China eliminates tariffs on almost twice as many goods as Taiwan, the economic benefits favour Taiwan more than China. On the trade in services listed on the early harvest programme, China also opens up more of its service sector for Taiwanese entrepreneurs to invest in on the mainland, such as banking, securities and futures, insurance and business services.² Taiwanese companies will be allowed to conduct a wider variety of business in China

than vice versa. In January 2011, the Cross-Strait Economic Cooperation Committee (ECC), composed of officials from the Straits Exchange Foundation (SEF) and the Association for Relations across the Taiwan Straits (ARTS), was formed to promote, oversee and carry out the economic agreement. It was decided during the ECC's first meeting in February 2011 to establish six working groups, including those on trade in goods, trade in services, dispute settlement, investment, industrial cooperation and custom cooperation, in order to complete ECFA-related follow-up negotiations.³

The establishment of an economic cooperation mechanism has implications not only for Taiwan and China but also for the future development of regional economic integration. Given China's economic significance in terms of GDP, trade volume, foreign investment and foreign reserves, and Taiwan's role as an important foreign investor and high technology producer in the region, the signing of ECFA indeed has its strategic importance in the region. Both Japan and South Korea expressed their concern over competition with Taiwanese manufactured products in the Chinese market after ECFA was initiated.⁴ In addition, the signing of ECFA, though a step forward in regional economic integration, also signifies a structural modification in the regional political economy. The regional production network has experienced great changes since China's emergence in recent decades. Some smaller economies in Asia have been displaced by China from their traditional export markets, owing to the switch of Foreign Direct Investment (FDI) from these economies to China. They have then sought a closer trading connection with China as well as with each other.⁵ For China, its signing of FTAs with neighbouring countries seems to firmly consolidate its commercial relations with the Asian economies. Putting the cross-Strait economic relationship within this changing regional context, this paper argues that Taiwan is actually following the wave towards a "China-centred" regionalization. The conventional "China-centred" regionalization concept would be further supported by the different sorts of FTA between China, Hong Kong, Macao and Southeast countries. This raises an important question as to whether this "China-centred" regionalization would challenge US influence in the region. In contrast to China, the US has been less involved in East Asia's economic integration process. The decreasing weight of trade with the US in Taiwan's and other Asian countries' total foreign trade signifies the more remote relationships between the US and East Asia.

The organization of this paper is as follows. It begins with an overview of the cross-Strait economic relations. Although China needed investment from Taiwan for its initial economic growth, as this division of labour across the Strait became mature, Taiwan found itself unable to break its economic connection with China. The recently signed ECFA will deepen the existing production network across the Strait and make the island's economy more

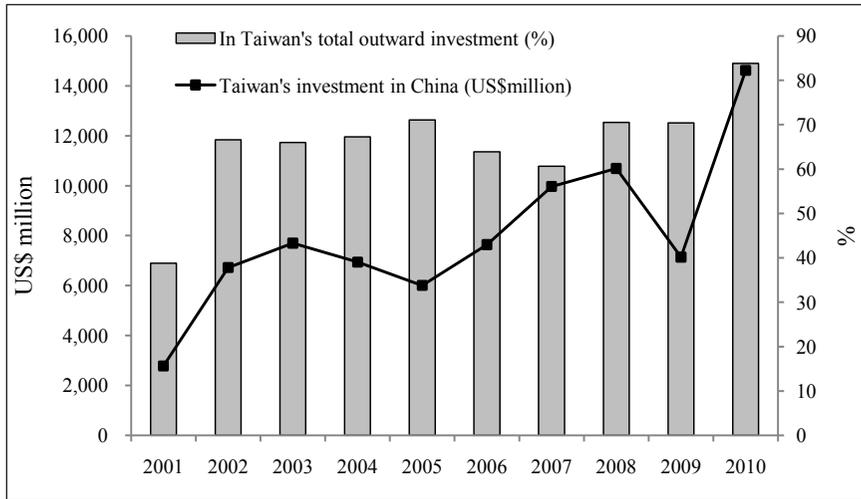
dependent on China. Both China and Taiwan's strategic consideration for ECFA will also be discussed. In general, Taiwan enjoys more economic benefits in the short term but ECFA will be in favour of China's political purpose in the longer term. Finally, the signing of ECFA symbolizes Taiwan's legitimate entry into the "China-centred" regionalization and further enhances China's gravity within regional economic integration. China's signing of free trade agreements, including the ECFA with Taiwan, CEPA with Hong Kong and Macao and the China-ASEAN FTA, signifies that future economic relationships with these economies are to be guaranteed. Owing to China's large economic size, potential consumption power and manufacturing capability, the "China-centred" regionalization will surely pose a challenge to the US. How the US will respond to this China-centred regionalization is critical to the future development of Taiwan-China relations as well as regional economic integration.

2. Overview of Cross-Strait Economic Integration

Cross-Strait economic contact was initiated even before the Taiwanese government had approved it. China's figures show that, before 1988, the cumulative amount realized by Taiwanese investments in China had already reached US\$22 million. It then jumped rapidly in one year to US\$160 million in 1989.⁶ During that time, Taiwan's outward investment, whether in China or in Southeast Asia, was to play a defensive role in retaining export markets for Taiwanese firms since the domestic investment environment was worsening. After 1990, Taiwanese investment in China surged to unprecedented levels as Taiwan's investment regulations regarding mainland China began to be progressively loosened. By 1993, according to Taiwan's Ministry of Economic Affairs (MOEA), the geographical distribution of Taiwanese investment had already changed significantly from Southeast Asia to China. The geographical proximity, similar culture and language and the overseas Chinese connection (*guanxi* 關係) also attracted Taiwanese investment to mainland China. The Asian financial crisis in 1997 promoted another rush of Taiwanese investment in China where the impact of the crisis was less serious. After 2000, while investment in other Asian countries such as in Singapore and Hong Kong continued to increase slightly, investment in other Southeast Asia countries decreased noticeably. However, investment in China still grew swiftly and massively. From 2000 to 2005, Taiwan's total investment in China (excluding Hong Kong) was 12 times larger than the investment in the combined Southeast Asia countries (Singapore, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam).

As shown in Figure 1, in 2001, Taiwan's investment in China was US\$2,784 million which accounted for around 39 per cent of Taiwan's total

Figure 1 Taiwan's Investment in China, 2001-2010



Source: Monthly Report 2010, Investment Commission, MOEA, Taiwan.

outward investment. But in 2010, Taiwan's investment in the mainland was US\$14,618 million, accounting for 84 per cent of Taiwan's total outward investment. Although Taiwan began to invest in the mainland later, its enormous investment has made it possible for it to catch up with other leading foreign investors in China in a short time. According to figures from the PRC's Ministry of Commerce, in 2010 the island's investment was US\$6.7 billion. About 6.3 per cent of total FDI in China was from Taiwan, which also made it the second largest foreign investor in mainland, only behind Hong Kong (see Table 1).

In addition, Taiwan's investment in China has traditionally concentrated on the manufacturing sector. The large amount of manufacturing investment in China not only constituted the principal Taiwanese investment on the mainland but Taiwan's outward investment in manufacturing is almost all in China. From 1991 to 2010, about 86 per cent of Taiwan's investment in China was in the manufacturing sector whereas the service sector took 12 per cent of Taiwan's total investment on the mainland (see Figure 2). The MOEA's figures also show that in 2010, 90.7 per cent (US\$10.8 billion) of Taiwan's outward investment in the manufacturing sector was in China whereas only 9.3 per cent (US\$1.1 billion) of Taiwan's manufacturing investment was in other countries.

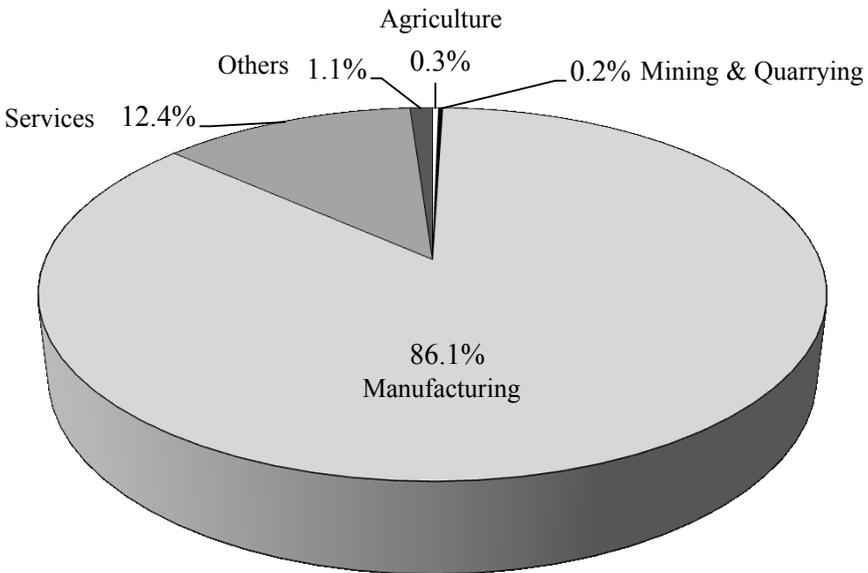
Among the different manufacturing sectors invested in China, *electronic parts and components* and *computers, electronic and optical products* were

Table 1 Top 10 FDI in China in 2010

Ranking	FDI Origin	Amounts (US\$ billion)	As % of Total FDI
1	HK	67.5	63.9
2	Taiwan	6.7	6.3
3	Singapore	5.7	5.4
4	Japan	4.2	4.0
5	US	4.1	3.9
6	South Korea	2.7	2.6
7	UK	1.6	1.5
8	France	1.2	1.1
9	Holland	1.0	0.9
10	Germany	0.9	0.9
Total		95.6	90.5

Source: Ministry of Commerce of the PRC.

Figure 2 Taiwan's Investment in China by Industry, 1991-2010



Source: Monthly Report 2010, Investment Commission, MOEA (in Chinese).

the main areas invested in by Taiwanese firms, which took about 19.6 per cent and 17.7 per cent of Taiwan's total manufacturing investment on the mainland, followed by *electrical equipment* (10.4 per cent), *fabricated metal products* (6.7 per cent) and *plastic products* (5.8 per cent) (see Table 2). This is different from two decades ago when traditional manufacturing sectors also took an important part of Taiwan's total investment in China.⁷ Another feature of Taiwan's manufacturing investment in China is the shift from labour-intensive industries led by small- and medium-sized firms to capital- and technology-intensive large enterprises. The increase in the size of each investment project clearly demonstrates this tendency. As Table 3 shows, the investment amounts for each investment was US\$0.74 million and increased to US\$18.8 million in 2010. The rise in value of each investment project suggests that many large Taiwanese enterprises with greater financial resources began to invest in China.

Table 2 Sectoral Distribution of Taiwan's Manufacturing Investment in China in 2010

Sectors	%	Sectors	%	Sectors	%
Electronic parts and components	19.6	Basic metal	3.0	Wearing apparel and clothing accessories	1.1
Computers, electronic and optical products	17.7	Manufacturing not elsewhere classified	2.8	Medical goods	0.8
Electrical equipment	10.4	Textiles mills	2.7	Beverages	0.7
Fabricated metal products	6.7	Pulp, paper and paper products	2.0	Wood and bamboo products	0.4
Plastic products	5.8	Motor vehicles and parts	1.9	Furniture	0.5
Machinery equipment	4.9	Chemical products	1.5	Petroleum and coal products	0.3
Chemical material	4.7	Other transport equipment	1.5	Printing and reproduction of recorded media	0.3
Non-metallic mineral products	4.6	Leather, fur and related products	1.4	Total	100
Food	3.1	Rubber products	1.4		

Source: Monthly Report 2010, Investment Commission, MOEA (in Chinese).

Table 3 Taiwan's Manufacturing Investment in China by Cases and Amounts, 1991-2010

	Number of Cases	Investment Amount (US\$1,000)	Amounts per Case (US\$1,000)
1991	235	173,058	736.4
1992	262	246,382	940.4
1993	8,432	2,955,618	350.5
1994	810	886,492	1,094.4
1995	409	998,576	2,441.5
1996	322	1,115,905	3,465.5
1997	7,756	3,902,660	503.2
1998	1,124	1,830,689	1,628.7
1999	422	1,166,098	2,763.3
2000	692	2,384,246	3,445.4
2001	879	2,513,959	2,860.0
2002	2,517	6,077,594	2,414.6
2003	3,084	6,807,514	2,207.4
2004	1,284	6,284,971	4,894.8
2005	901	5,281,921	5,862.3
2006	774	6,649,291	8,590.8
2007	652	8,765,998	13,444.8
2008	401	8,761,185	21,848.3
2009	404	5,892,078	14,584.4
2010	576	10,840,822	18,820.9

Source: Monthly Report 2010, Investment Commission, MOEA (in Chinese).

The expansion of investment in China deepened the production network between the two sides and therefore induced Taiwanese exports to China. During the past decade, trade between Taiwan and China has progressed even more significantly. As shown in Table 4, in 2001, according to Taiwan's official figures, Taiwan's imports from China was about US\$5,904 million and only accounted for about 5.5 per cent of the island's total imports. However, it enlarged 6 times and accounted for 14.3 per cent of Taiwan's total imports in 2010. Taiwan's exports to China also increased from US\$4,895.3 million in 2001 to US\$76,935 million in 2010, and about 28 per cent of Taiwan's total exports were designated for the mainland. If exports to Hong Kong are included, Taiwan's total exports to China are over 40 per cent of the island's total exports. Exports to the mainland and Hong Kong together accounted for

Table 4 Trade Relationships between Taiwan and China, 2001-2010

	Taiwan				China				US\$ million; %
	Imports from China		Exports to China		Imports from Taiwan		Exports to Taiwan		
	Amounts	As % of Taiwan's total imports	Amounts	As % of Taiwan's total exports	Amounts	As % of China's total imports	Amounts	As % of China's total exports	
2001	5,903.8	5.5	4,895.3	3.9	25,497.1	11.3	5,039.9	2.0	
2002	7,968.3	7.0	10,526.7	7.8	27,344.0	11.2	5,001.7	1.9	
2003	11,017.5	8.6	22,890.3	15.2	38,082.5	12.9	6,589.6	2.0	
2004	16,791.5	10.0	36,349.0	19.9	49,364.2	12.0	9,013.8	2.1	
2005	20,093.1	11.0	43,643.3	22.0	64,759.6	11.6	13,547.8	2.3	
2006	24,782.3	12.2	51,808.2	23.1	74,655.1	11.3	16,558.7	2.2	
2007	28,014.1	12.8	62,416.4	25.3	87,140.6	11.0	20,739.5	2.1	
2008	31,390.5	13.1	66,883.0	26.2	100,985.9	10.6	23,480.4	1.9	
2009	24,422.6	14.0	54,248.1	26.6	103,325.0	9.1	25,885.7	1.8	
2010	35,952.1	14.3	76,935.4	28.0	85,706.0	8.5	20,466.3	1.7	

Note: All the above figures do not include Taiwan's trade with Hong Kong.

Source: The Bureau of Foreign Trade, MOEA, Taiwan, for Taiwan's trade with China; GTI-World Trade Atlas for China's trade with Taiwan.

about 27 per cent of Taiwan's GDP. The high exports to China also meant Taiwan maintained its trade surplus and contributed to its enormous foreign exchange reserves. In 2010 for example, Taiwan's trade surplus *vis-à-vis* China and Hong Kong was about US\$77 billion but Taiwan's total trade surplus was around US\$23 billion. If there were no trade surplus with China, including Hong Kong, Taiwan would not be able to finance its imports from Japan and South Korea and its trade balance would be in deficit.⁸

The typical pattern of Taiwanese investment in China is to import intermediate and capital goods from Taiwan and export finished goods to developed countries, mainly the US. Hence, most of Taiwan's exports to China were driven by Taiwanese enterprises investing in China for procurement purposes. In 2010, for example, around 44 per cent of Taiwan's exports to China were electronic machinery and 18 per cent was optical and photographic related products.⁹ Meanwhile, as part of China's total export volumes, Taiwanese enterprises on the mainland also play an important role. According to the *Top 200 Exporting Companies in China* issued by the PRC's Ministry of Commerce, in 2009, among the top 10 exporting companies in China, 7 of them were Taiwan enterprises' children companies. In particular, Taiwanese owned firms, Quanta Computer, Foxconn and Compal, were the three leading exporting companies in China. These large Taiwanese export-oriented companies are registered in third places and mean that the official figures concerning Taiwan's investment in China is rather low.

In brief, cross-Strait relations in trade and investment over the past decades show an asymmetric dependence of China on Taiwan's investment in manufacturing to support its export-driven economic development. What Taiwan has gained in return is the expanding economies of scale that lowers costs in order to keep their products competitive in the international market. Although China needed investment from Taiwan initially for its economic growth, when this division of labour across the Strait became mature, Taiwan found that it could no longer break its economic connection with China. Taiwan needs exports to China to sustain its economic growth. In other words, China's dependence on Taiwan's investment finally resulted in Taiwan's reliance on trade with China. The intensified economic integration finally brought about an institutionalized economic relationship.

3. China: A Political Look from Taiwan Strait to across the Pacific Ocean

The principal motivation behind China's signing up of ECFA is political and Chinese leaders have not hidden their wishes for unification with Taiwan in several public speeches. In fact, Beijing has actively promoted cross-Strait commercial expansion as part of an "embedded reunification" strategy

since the leadership of Deng Xiaoping 鄧小平.¹⁰ Chinese Vice-Minister of Commerce, Gao Hucheng 高虎城, has mentioned that the agreement was an arrangement made under the precondition of “one China” and the “1992 consensus”.¹¹ In January 2011, a Chinese government spokeswoman further stated that relations between the mainland and Taiwan will not be improved if the “1992 Consensus” is not observed.¹² During China’s National People’s Congress in March 2011, Premier Wen Jiabao 溫家寶 highlighted in a government work report that China “... will adhere to the major principles and policies for developing relations between the two sides of the Taiwan Straits and promoting the peaceful reunification of our motherland in the new situation”.¹³ In fact, “One Country, Two Systems” has been the principal of PRC’s policy towards Taiwan and China has not changed this. The minimal amount of economic benefit for China could foster Taiwanese economic dependency and further advance China’s political agenda of unification with Taiwan.¹⁴ Apart from the political intention, economically, ECFA would ensure the continued inflow of Taiwan’s investment, which has been important to support China’s export-driven economy as already mentioned. Since the 1990s, Taiwan’s manufacturing investment in China has successfully integrated the mainland into the regional production network. The facilitation of Taiwan’s investment to the mainland will be helpful for China’s further industrialization and development. Moreover, Taiwan is a small economy with only a population of 23 million. Its domestic market is not so attractive for Chinese entrepreneurs. Inducing Taiwan’s financial capital into the mainland is therefore more essential than asking Taiwan to open up its market.

At the regional level, ECFA served as a step forward in China’s growing economic connection with the region. After its accession to the World Trade Organization (hereafter WTO) in 2001, China moved quickly to develop its free trade ties with other economies. The most significant was its FTA with ASEAN countries, namely ASEAN+1 in 2002. In 2004, the Agreement on Trade in Goods of the China-ASEAN FTA was signed and entered into force in July 2005. In January 2007, the two parties signed the Agreement on Trade in Services, which entered into effect in July of the same year. In August 2009, the two parties signed the Agreement on Investment. Under this Agreement, the 6 original ASEAN members (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) and China had to eliminate tariffs on 90 per cent of their products by 2010. The remaining four countries (Cambodia, Lao PDR, Myanmar and Vietnam) will follow suit by 2015. In 2003, China signed the “Closer Economic Partnership Arrangement” (CEPA) with Hong Kong and Macao respectively. As it offers a better deal than China’s WTO commitments, CEPA strengthened Hong Kong’s role as a platform for doing business in China. Supplementary measures of CEPA were signed from 2004 to 2009. In addition, China concluded FTAs with Singapore and New Zealand

in 2008. Meanwhile, China is also looking for expanding its economic ties with Japan and South Korea via ASEAN+3. Some regard China's FTA strategy as an integral part of its "peaceful rise" policy which aims to escalate Chinese influence in the region politically and economically. FTAs with neighbouring countries would not only ease the "China threat" concerns but also safeguard foreign raw material imports.¹⁵

In fact, market forces have since a long time been in the leading position to direct East Asia's economic integration and China's increasing FTAs have also been supported by its growing economic and commercial ties with its neighbouring countries. China has already replaced the US to become the largest export destination for ASEAN, Taiwan, Hong Kong, Japan and South Korea. At the same time, China also seeks the expansion of its exports to neighbouring countries. Chinese leaders hope that, with continued progress in FTA, Chinese products can penetrate into more countries and therefore minimize the impact of dependence on Western markets.¹⁶ Especially after the global financial crisis in 2008, the slowdown of Western countries' demand made many Asian countries realize the importance of export diversification. Compared with the US's exports, China's exports to Japan, Taiwan, South Korea, Hong Kong and ASEAN were greater in terms of absolute amount.

From 1991 to present, China has kept an annual economic growth rate above 8 per cent. When the global financial crisis damaged many economies around the world, China's economy, although it was also hit by the decline of global demand, stood relatively firm.¹⁷ Since 2010, China's economy has surpassed Japan as the world's second largest in terms of GDP, only behind the US.¹⁸ In terms of trade and investment, China has been significant not only at the regional level but also in the world. It was also one of the most attractive investment destinations in the world. In 2009, WTO's figures shows that China was the largest exporter and second largest importer in the world, only behind the US, unless the European Union is treated as a single unit. Owing to its large exports, China has the world's largest current account surplus and owns a third of world's currency reserves.

Even without massive outward investment in other countries, thus further establishing a regional production network – just as Japan had done so before it – China, with its huge economic size and recent progress in FTAs with major economies in East Asia, has also strengthened its significant role in connecting the regional economies. By contrast, the US's role in regional economic integration has diminished to some extent. China's deepening economic engagement with Asian economies, together with its huge economic size, population and influence in world affairs, signifies that China will inevitably play a dominating role in the regional political economy. China's rising economic dominance in the region is also posing a challenge to the US presence in East Asia.

4. Taiwan: Standing with the Giant towards the China-Centered Regionalization

In contrast to China's increasing economic openness to Taiwan over the last decade, the Taiwanese government showed more hesitation in opening up its economy to China. However, the uncontrollable rising economic interchanges forced Taiwan's government to legalize the economic relationship with China.¹⁹ Seeing the unavoidable rising economic interaction across the Strait, the establishment of a more formerly legalized economic relationship with China became urgent for Taiwan. Different from China, Taiwan's willingness to sign ECFA with China was therefore not to promote the cross-Strait economic relationship. But rather, it was more a passive reaction by the government to the uncontrollable ever-closer relationship with the mainland.

Ma's administration took ECFA as being comparable to an FTA and as a means to promote the island's economic growth. On one hand, Taiwan has been excluded from the growing free trade agreements in recent years because of China's pressure. Prior to ECFA, Taiwan had only signed FTAs with a few countries in Central and South America (Panama, Honduras, Guatemala, Nicaragua and Salvador) which accounted for a small proportion of Taiwan's external trade. This worried the government, especially when the FTA between China and ASEAN took effect on 1 January 2011. ASEAN's further trade negotiations with China, Japan and South Korea to form ASEAN+3 is believed by the government to further diminish Taiwan's economic significance in the region. As a result, the threat of marginalization in the region pushed Taiwan's government as well as Taiwanese entrepreneurs to pursue an economic agreement with China, Taiwan's most important trading partner. On the other hand, a sustained economic prosperity subsequent to the deepened economic relationship between Taiwan and China may help the KMT to retain the Presidency in 2012. Although Taiwan's economic success in the past might not have been directly linked to the KMT's economic policy,²⁰ the Democratic Progressive Party (DPP)'s inability to further advance the island's economic development during Chen's presidency, and its failure to provide a credible alternative to the ECFA, provide the KMT much room in promoting ECFA.

According to the Taiwanese government's estimates, economically, ECFA would raise Taiwan's economic growth rate between 1.65 per cent and 1.72 per cent and increase total employment by about 2.5~2.6 per cent, that is, approximately 26,000 new jobs will be created after ECFA takes effect.²¹ With just over 1.3 billion population, China's domestic market is not only huge but also rapidly growing. Many foreign investors found it difficult to enter. Taiwan, with its similar linguistic and cultural background, its closer and a legalized economic relationship with China, is likely to catch the attention of foreign investors who will want to cooperate with Taiwanese entrepreneurs

in the Chinese market or setting up R&D centres on the island. As China's economy is expected to be prosperous in the following years, Taiwan, due to its geographic proximity with China, and its strong connection with mainland, has the potential to become a logistics centre in the region.

Nonetheless, as China is still not an essential export market for final goods, Taiwan's dependence on the mainland for its export-led economic growth has its limits. In 2009, for example, the export of goods and services contributed to 60.5 per cent of Taiwan's economic growth rate.²² Although China is Taiwan's largest export destination, Taiwan's exports to China are based on their production network. In 2010, about 50 per cent of Taiwan's exports to China were electrical machinery and optical instruments. European Union countries and the United States are the main export market for China. In 2010, these two markets accounted for 38 per cent of China's total exports. Most of the exports from China to the US and EU are final goods. The increase or decrease of China's imports from Taiwan is therefore dependant on the EU and US demand for final goods.

Although it seems that ECFA would enable Taiwan to gain more economic benefits than China gets from Taiwan, Taiwan's position at the negotiating table with China will weaken in the future. The reason is that the release of economic privileges from China will mean that the island's economy will increasingly depend on the mainland rather than vice versa. The strong economic link with China signifies a powerful impact on a small economy such as Taiwan's, if there are any changes to China's economy, including China's economic policies changes and economic fluctuation caused by global financial turmoil or business cycles.

Comparing Taiwan and China's main trading partners (see Table 5), Taiwan was China's 5th importer and China was Taiwan's largest export destination in 2010. However, most of the imports from Taiwan are industrial goods which are highly substitutable by other industrial goods from Japan, South Korea and some ASEAN countries. This is why ECFA made Japanese and Korean manufacturers feel threatened as a high percentage of Korean and a considerable share of Japanese exports to China overlap with those from Taiwan. Therefore, if there is any disagreement between Taiwan and China, China can switch its import sources from Taiwan to Japan and South Korea. It would be difficult for Taiwan to find a substitute market for its export of semi-industrial goods, originally designated for manufacturing firms in China in the short term. Meanwhile, contrary to the mainland's huge domestic market, Taiwan is not a key export market for China. In 2010, Taiwan was China's 11th largest export market. China's exports to Taiwan only accounted for less than 2 per cent of China's total exports. The opening up of Taiwan's market to China is thus not really essential for China but Taiwanese imports from China are important. China was Taiwan's second largest import source. In 2010, 14.2

Table 5 Taiwan and China's Main Trading Partners in 2010 (percentage)

	China		Taiwan	
	Main Import Sources	Main Export Destination	Main Import Sources	Main Export Destination
1	Japan (12.7)	EU27 (19.7)	Japan (20.8)	China (27.8)
2	EU27 (12.1)	US (17.9)	China (14.2)	ASEAN10 (15.4)
3	ASEAN10 (11.1)	HK (13.8)	ASEAN10 (11.5)	HK (13.1)
4	South Korea (9.9)	ASEAN10 (8.8)	US (10.0)	US (11.6)
5	Taiwan (8.3)	Japan (7.6)	EU 27 (8.4)	EU27 (10.4)
6	US (7.3)	South Korea (4.4)	South Korea (6.4)	Japan (6.5)
Total	61.4	72.2	71.4	84.8

Source: GTI-World Trade Atlas.

per cent of Taiwan's total import was from China. In brief, Taiwan depends on China for exports much more than China depends on Taiwan. ECFA promotes the trade between the two sides and at the same time deepens Taiwan's trade dependence on the mainland.

Moreover, the Taiwanese government's expectation that China will allow Taiwan's negotiation of FTAs with other countries is doubtful. Even though the cross-Strait relationship has much improved in recent years, Taiwan's "appearance" on the global stage is still a sensitive issue for Chinese leaders. Soon after Taiwan signed ECFA with China, both Singapore and the Philippines expressed their interests in negotiating FTA with Taiwan.²³ But the Chinese government continued to object to foreign countries signing free trade agreements with the island. Furthermore, the US arm sales to Taiwan and the uncertainty of Taiwan's political climate after the 2012 presidential election will also make continuous progress of ECFA and Taiwan's FTA with other countries uncertain.

5. Concluding Remarks

Cross-Strait relations in trade and investment over the past decades have shown an asymmetric dependence of China on Taiwan's investment in manufacturing to support its export-driven economic development. What Taiwan has in return are expanding economies of scale that lowers costs in order to maintain the competitiveness of its products in the international market. Although China initially needed investment from Taiwan for its

economic growth, when this division of labour across the Strait became mature, Taiwan found that it could no longer break its economic connection with China. In other words, China's dependence on Taiwan's investment finally resulted in Taiwan's reliance on trade with China.

Contrary to the conventional thinking that China's signing of ECFA is for political purpose and Taiwan has more economic concerns, this paper shows China's economic consideration and Taiwan's political reason. Politically, ECFA serves China's reunification purpose with Taiwan and the current ruling party KMT would also benefit from it to win the presidential election in 2012. From an economic perspective, ECFA would ensure the continued investment from Taiwan to China, which is an essential element for China's further industrial upgrading. As Taiwan's domestic market is limited, the opening up of Taiwan's market is not important for China. In the long term, a closer economic relationship would have more potential impact on Taiwan than on China, due to their different economic sizes. Taiwan's political sovereignty will also be undermined. In addition, the signing of ECFA symbolizes Taiwan's legitimate entry into the "China-centred regionalization" process and further enhances China's gravity in the regional economic integration

ECFA would allow Taiwan to go a step closer to China, economically and then politically, which also means a step away from the United States. But contrary to the resistance to deepening the relations with China by Taiwan's opposition party, the Obama administration in the US has generally welcomed the economic engagement between the two sides as it will be helpful in reducing the tension in the Taiwan Strait and benefit the region's stability. American officials not only responded positively to the signing of ECFA but even called for further exchanges between Taiwan and China.²⁴ Prior to the conclusion of ECFA, Washington reconfirmed its commitment to a one-China policy based on the three US-China communiqués and the Taiwan Relations Act.²⁵

In fact, America's response on ECFA was not surprising. The US has long been excluded from the regional economic integration. In contrast to China, which has signed FTAs or quasi-FTAs with the main economies in East Asia in recent years, the US has only signed an FTA with Singapore in 2004. The only regional free trade agreement negotiation that involved the US was the Free Trade Area of the Asia Pacific (FTAAP). In 2009, President Obama announced the US's intention to enter into negotiations for a free trade agreement with Asia-Pacific, known as the Trans-Pacific Partnership (TPP) Agreement, with the objective of shaping a high-standard, broad-based regional pact. The US has demonstrated its desire to increase its engagement in Asia by entering into the TPP talks but it is still premature to assume that TPP can be successfully negotiated.²⁶ In addition, the current members in negotiation over TPP with the US (Brunei, Chile, New Zealand, Singapore,

Australia, Malaysia, Peru, United States, and Vietnam) are not important trading partners for America. The potential economic benefits are therefore not significant and the final approval of the TPP by the US Congress is uncertain. The “high quality” issue in TPP, such as agriculture, intellectual property protection, services, labour and the environment, are also possible to barriers to some ardent free traders.

Even though it seems that China engages more in East Asia’s economic integration than the US, the increasing trade between China and the rest of the region did not divert trade from America. The US and European Union countries still act as the major destination of final products for China. In 2010, EU and the US were China’s two largest export destinations, and accounted for 19.7 per cent and 17.9 per cent of China’s total exports respectively. China’s economic opening up has enlarged the original regional production network but it has not changed the US-Asia commercial relationship. The original US-Asia supply and demand relationship that caused the American trade deficit still remains the same. The only thing that has changed is that the trade deficit with Japan and the NIEs has been replaced with a trade deficit with China.

The trade agreements with Taiwan, Hong Kong, Macao, and ASEAN may not only strengthen China’s existing trade relationship with them but also amplify China’s importance in the regional trading bloc. Since China’s economic force is based on foreign investment with export-oriented production, the “China-led” regionalization is therefore vulnerable to the external environment. Therefore, in the short term, the trade agreements privilege small economies by consolidating their connection with China. China is unable to challenge US dominance at this moment. However, in the long term, it is highly possible that a “China-led” Asia will be on the collision course with the US-led West for global economic leadership. How will the US respond to China’s current rising dominance in the regional economy is critical for the future development of economic integration in East Asia and global economic stability.

Notes

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1. That political agreement is: There is one China and Taiwan is part of China and both sides can express their different meaning on "One China", whether it is one China under KMT or CPC leadership. This is also referred to as "1992 Consensus" as it is claimed to result from political discussions between the two sides (Taiwan-based Strait Exchange Foundation and China-based Association for Relations across the Taiwan Strait) in Hong Kong in 1992. However, some pro-Taiwan independence politicians oppose this principal and argue that there was no such political agreement between Taiwan and China in 1992.
2. In the financial sector, Taiwanese banks are allowed to conduct Renminbi (the Chinese currency, hereafter RMB) business on the mainland after 2 years of business operation in China, which is superior to the WTO treatment (requiring 3 years of operation and 2 years of profits). In the non-financial services sectors listed in the early harvest programme, except for professional services and accounting, auditing services, which are equal to WTO treatment, the other ones are superior to the WTO treatment. Taiwanese services suppliers will be allowed to set up wholly-owned enterprises in China. The 9 services items Taiwan opens to China are basically equivalent to those that China has agreed to open, except for convention and communication services.
3. "First Cross-Strait co-op committee meets in Taiwan", *China Daily*, 22 February 2011, <http://www.chinadaily.com.cn/china/2011-02/22/content_12060834.htm> (accessed 5 May 2011).
4. However, Japan and Korea's reaction regarding ECFA was different. Japanese businesses took Taiwan as a short-cut to successfully enter into Chinese market after ECFA was put into practice while Korean entrepreneurs urged its government to sign a trade agreement with China. "Taiwan challenges to Korea, Japan", *Asia Times online* <http://www.atimes.com/atimes/China_Business/LG22Cb01.html> (accessed 29 March 2011).
5. *Emerging Asian Regionalism: A Partnership for Shared Prosperity*, Asian Development Bank, December 2008, pp. 58-66.
6. The figures are selected from Taiwan Affairs Office of State Council, PRC.
7. In 1991, food and beverage processing accounted for 15.8 per cent of Taiwan's total manufacturing investment in China while 18.4 per cent was in plastic products, 22 per cent was in textiles, gourmet and footwear and 25.8 per cent was in electronic and electrical appliances. See Min-Hua Chiang (2010), *Taiwan in the Web of US Hegemony 1949-2005*, VDM Publishing House Ltd., Saarbrücke, Germany, p. 195.
8. Japan and South Korea are Taiwan's two major trade deficits sources. In 2010, Taiwan had US\$33.9 billion trade deficit with Japan and US\$5.4 billion trade deficit with South Korea.
9. Figures calculated from GTI-World Trade Atlas.
10. Christopher M. Dent, "Taiwan and the New Regional Political Economy of East Asia", *The China Quarterly*, No. 182, June 2005, p. 400.

11. Li Ching-Lieh, "ECFA must guarantee free-trade agreements", *Taipei Times*, 12 August 2010 <<http://www.taipeitimes.com/News/editorials/archives/2010/08/12/2003480148>> (accessed 5 May 2011).
12. "Chinese spokeswoman stress importance of 1992 Consensus to improving Cross-Strait relations", Spokesperson's remarks, Taiwan Affairs Office of the State Council PRC, 12 January 2011 <http://www.gwytb.gov.cn/en/SpokespersonRemarks/201103/t20110316_1788627.htm> (accessed 4 May 2011).
13. "Report on the Work of the Government", delivered at the Fourth Session of the Eleventh National People's Congress, 5 March 2011 <<http://online.wsj.com/public/resources/documents/2011NPCWorkReportEng.pdf>> (accessed 4 May 2011).
14. *2010 Report to Congress of the US-China Economic and Security Review Commission*, November 2010, U.S. Government Printing Office, pp. 145-146.
15. Pasha L. Hsieh, "The China-Taiwan ECFA, Geopolitical Dimensions and WTO Law", *Journal of International Economic Law*, Vol. 14, No. 1, p. 132.
16. China FTA Network.
17. In 2009, the economic growth rate was -3.9 per cent in Euro Area, -5.4 per cent in Japan, -2.5 per cent in the US and -2.2 per cent in developing countries, excluding China and India. China's economic growth rate was 9.2 per cent. The World Bank, *Global Economic Prospect: Crisis, Finance and Growth*, 2010, Washington, p. 3; IMF, World Economic Outlook Database, April 2011.
18. In 2010, China's GDP was valued US\$ 5.87 trillion, US was US\$ 14.67 trillion and Japan's was US\$ 5.46 trillion. IMF, World Economic Outlook Database, April 2011.
19. As China is becoming more open to the global economy, China's FDI promotion policy and the opening up of the US market to China's products are more powerful than the Taiwan government's unilateral restrictions on trading with and investing in the mainland. As a result, the Taiwanese government could only open its economic door to China subsequent to this unavoidable closer economic relationship with China.
20. Generally, Taiwan's development can be characterized by three principal influences. The first is the considerable contribution of private enterprises to the economic boom. The second influence is the appropriate state policy. Those scholars who emphasized the state argued that the exploitation of comparative advantage in Taiwan as well as in other Newly Industrializing Countries (hereafter NIC) was through the governments' industrial planning. From the statist viewpoint, a strong government was the key to rapid growth as the state's autonomous power facilitates the national growth strategy and prevents policy distortion due to opposition from domestic interest groups. Thirdly, some argue that the international economic environment played an even more important role in shaping Taiwan's economic transformation. External influences, including the Japanese colonial legacy, US aid at the initial stage of post-war development and subsequent economic dependence on the US and Japan, are all indispensable to Taiwan's economic success.
21. Ministry of Economic Affairs, Taiwan <<http://www.ecfa.org.tw/index.aspx>> (accessed 2 April 2011).

22. *Taiwan Statistical Data Book 2010*, CEPD, Taiwan, Table 3-9b, p. 66.
23. “Philippines, Singapore FTAs to follow ECFA”, *The China Post* <<http://www.chinapost.com.tw/business/asia/asian-market/2010/05/21/257419/Philippines-Singapore.htm>> (accessed 30 March 2010).
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26. Russell Smith, “Trans-Pacific Partnership: A Current Policy Assessment” <<http://www.safehaven.com/article/20085/trans-pacific-partnership-a-current-policy-assessment>> (accessed 5 May 2011).

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