

Taiwan's strategy after the framework agreement with China

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The Economic Cooperation Framework Agreement (ECFA) that Taiwan and China signed on June 29 this year is a milestone in relations across the Straits. It normalises economic relations between Taiwan and the Mainland. Up to this point, Taiwan has had discriminatory trade and investment policies towards China under the guise of political-security concerns that severely limited economic engagement across the Straits. These measures meant that Taiwan had effectively cut itself off from participating fully in the East Asian production networks.



Taiwan is now free to institutionalise economic relations with other important trading partners such as the US, Japan, EU, ASEAN and [Australia](#)^[1]. Is it in Taiwan's best interest to now join the FTA game with partners around the region and around the world?

There is a strong desire in some quarters in Taiwan to sign preferential trade deals now that it can and there will be pressure from external powers too. Taiwan may seek to sign trade deals for geopolitical reasons, but not for economic reasons.

The economic rationale for Taiwan to join the FTA game is weak.

The best economic argument for FTAs are that Doha is stalled and liberalisation via FTAs is the only alternative and may be better than nothing. There is now enough evidence that this isn't the case (see work by [Philippa Dee in the World Economy](#)^[2]). Taiwan has very little leverage in negotiating trade access bilaterally with its major trading partners. So unilateral liberalisation is a better option. Unilateral liberalisation has served East Asia well in the past and the principle of open regionalism has brought into being a region that is economically much more integrated

than Europe or North America, yet depends on those markets for final goods exports. There is evidence of this in recent studies by [Zhi Wang](#)^[3] (pdf) and [myself and Peter Drysdale](#)^[4].

Taiwan is ideally placed to pursue a global strategy, and a strategy that focuses on domestic structural and regulatory reforms. The economic gains from structural reforms dominate gains from FTAs, even if FTAs are region wide. [Estimates](#)^[5] suggest that comprehensive unilateral regulatory reforms would deliver five times the gains of an ASEAN+3 agreement. The gains from bilateral FTAs are trivial.

Now that Taiwan can 'go global', a strategy of getting its own house in order will deliver larger gains, and faster, than when Taiwan had effectively cut itself off from China. A global strategy does not discriminate in trade dealings and instead lets market forces determine trade flows and economic integration. Making the Taiwanese economy stronger, more flexible, efficient and resilient will help it reap the gains from globalisation and integration into the Asian and global economy. ECFA is a framework for removing that discrimination against China; Taiwan should not now introduce discriminatory trade elsewhere.

The China-ASEAN FTA which comes into force next year is viewed by some as a threat to Taiwan and others in Asia that aren't party to it. There is hope that it sets off [competitive liberalisation](#)^[6] through other FTAs. That would add more noodles to the mess of FTAs in the region. To date Taiwan has only signed 4 FTAs and they are with Central American countries that do not have significant trade shares in Asia. So Taiwan has a clean slate when it comes to FTAs.

The political capital and resources required in negotiating and signing FTAs are better spent elsewhere. There are political risks to Taiwan signing preferential deals with other countries that discriminate against the mainland. [Article 16 of the ECFA](#)^[7] is a termination clause where either China or Taiwan can notify the other of termination of the ECFA which takes effect 180 days later.

Taiwan can minimise political risk and maximise economic gains if it enters bilateral arrangements that avoid preferential treatment or allow ready sign-on by other countries. Taiwan has strongly pushed that point in one of its very few [submissions to the WTO](#)^[8]:

we propose new provisions... requiring parties of RTAs to provide an accession clause for third-party members, which would expand the reach of RTAs and thereby promote broader, more inclusive and comprehensive trade liberalization (paragraph 7)

third parties will not be granted automatic accession to RTAs. However, the original parties to the RTAs will be required to afford third parties, in good faith, adequate opportunity to negotiate individual terms of accession to the RTAs (paragraph 9)

(h/t to [John Ravenhill](#)^[9]).

Taiwan lifted itself into prosperity without FTAs despite, but also because of, its being politically between a rock and a hard place. Commitment to the multilateral trading system through unilateral tariff liberalisations, in which APEC played a significant role, was one way of doing that. Recent economic troubles, which gave the government a window of opportunity to sign ECFA, were not the result of Taiwan's inability to join FTAs. They resulted from the global economic slowdown and significantly Taiwan's being left out of the East Asian production networks.

The restrictions on trade and investment across the Strait have prevented deepening of Taiwan's specialisation in the regional and international economy. This has slowed Taiwan's climb up the value-added chain. Taiwan has not been able to add value to some cheap intermediate imports from China and is limited in what it can export to China. Taiwanese firms have not been able to take full advantage of China's upstream or downstream processing capacity. As recently as 2006, Taiwan's imports from China were half of what might have been expected given the size of the Chinese and Taiwanese economies, their distance apart and their trade structure. Taiwan's imports from China was less than 50 per cent of its potential. Korea's trade with China, for example, was much closer to its potential than was Taiwan's trade with China (see references [here](#) ^[10]). This severely limits the engagement of foreign MNEs in Taiwan as they look to participation in production networks with China as part of the advantage of location in East Asia.

FDI into Taiwan has been low and there is much fanfare that Taiwan will now become a more attractive destination after ECFA. Some wrongly point to the [lack of FTAs as the reason](#) ^[11] low FDI in Taiwan. The real reason is that by severely limiting trade flows with the mainland, Taiwan was not an attractive destination for foreign capital. Everything else equal, why build a factory in Taiwan when you could set up in Korea or Vietnam, for example, and enjoy relatively unfettered trade with China, one of the largest, most dynamic and most important economies in the region.

Pursuing deep domestic reforms is not an easy strategy to pursue when there is pressure to sign FTAs. It may seem a lonely strategy although that is nothing new for Taiwan. But given its unique circumstance, Taiwan is in a position to become an exemplar of a new drive towards multilateral liberalisation and structural reform. Efficient specialisation in the international economy involves heavy interdependence across the Straits: global engagement reduces the economic and political risks associated with that.

It may be an outlier in the region but the economic gains and minimisation of geopolitical complications that come with a strategy that eschews preferential trade agreements is likely to provide maximum momentum and confidence in taking Taiwan's economy to the next level.

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[1] Australia:

<http://www.theaustralian.com.au/news/opinion/forget-doha-time-for-trade-deals-in-asia/story-e6frg6zo-1225921416811>

[2] Philippa Dee in the World Economy:

<http://onlinelibrary.wiley.com/doi/10.1111/j.1467-9701.2006.00826.x/full>

[3] Zhi Wang:

<http://www.eastasiaforum.org/wp-content/uploads/2010/11/20101029BeyondECFAZhiWang1.pdf>

[4] myself and Peter Drysdale: <http://ideas.repec.org/p/eab/wpaper/2187.html>

[5] Estimates: <http://onlinelibrary.wiley.com/doi/10.1111/j.1467-9701.2006.00826.x/full>

[6] competitive liberalisation: <http://www.iie.com/publications/wp/wp.cfm?ResearchID=171>

[7] Article 16 of the ECFA: <http://www.bilaterals.org/spip.php?article18166>

[8] submissions to the WTO: <http://www.wtocenter.org.tw/SmartKMS/fileviewer?id=68581>

[9] John Ravenhill:

<http://www.eastasiaforum.org/wp-content/uploads/2010/11/20101029BeyondECFARavenhill.pdf>

[10] here: <http://ideas.repec.org/p/eab/wpaper/2310.html>

[11] lack of FTAs as the reason:

<http://www.theaustralian.com.au/news/opinion/forget-doha-time-for-trade-deals-in-asia/story-e6frg6zo-1225921416811>

[12] here: <http://ideas.repec.org/p/eab/wpaper/2310.html>