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The Implications of China-Taiwan Economic Liberalization

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On June 29, 2010, representatives of China and Taiwan signed an Economic Cooperation Framework Agreement (ECFA) in Chongqing, China. The agreement is a road map to a comprehensive bilateral free trade agreement (FTA) covering most aspects of economic relations across the Taiwan Strait. Whether that map will be followed faithfully is not a given, but the initial “early harvest” terms—reduction in tariffs on selected products—are a strong down payment. Though significant in economic terms, ECFA’s significance is more than that. China regards Taiwan as a renegade province, while Taiwan sees itself as either *de facto* or *de jure* independent of the mainland, depending on whom you ask. The legacy of 20th century Chinese history has kept the sides apart in many ways, even while the two have developed one of the most interdependent, albeit asymmetric, commercial relationships in the world. China is generally open to Taiwanese trade, investment, and labor, while Taiwan has been far more restrictive toward reciprocal flows from China.

ECFA is poised to revise this asymmetric status quo in terms of the flow of trade, investment, and people. China sees ECFA as drawing Taiwan closer in sociological terms and thus has a logic independent of commercial considerations. It sees the undertaking as a step toward winning Taiwanese hearts and minds while turning the page on vestiges of the Cold War past. For Taiwan, the agreement is key to maintaining parity with countries in the region, including in the Association of Southeast Asian Nations (ASEAN), which are moving ahead with deepening arrangements with China. China’s relative strength through the financial crisis of 2008–09 and beyond made it even clearer that deepening cross-strait relations is imperative.

Myriad political, political-economy, security, and commercial and economic questions arise from the policy development of closer cross-strait economic relations. Rosen and Wang attempt to make it easier to analyze and answer many of these questions by clarifying the long-term economic implications of cross-strait liberalization. They compare the economic effects of ECFA with business as usual for both China and Taiwan and also model implications should Taiwan pursue additional trade agreements beyond the Taiwan Strait (e.g., by joining ASEAN plus China [ASEAN+1] or plus China, Japan, and South Korea [ASEAN+3] undertakings). The authors also explore the strategic significance of closer China-Taiwan economic relations for interested third parties, most importantly the United States.

The benefits for Taiwan lie more in normalizing an abnormal cross-strait economic relationship than in further liberalizing other relationships. Taiwan interacts with other World Trade Organization (WTO) members on a most favored nation (MFN) basis, but its relations with China are distorted by its own policy interventions that block imports and investment. Hence liberalizing *that* relationship stands to deliver the greatest benefit. The projected benefits of ECFA compared with business as usual are large for Taiwan and modest for China. Taiwan would look at gains greater than 4 percent on whatever GDP turns out to be after 10 years as a result of ECFA. On a sector level, Taiwan would experience considerable structural adjustment under ECFA, and it is that adjustment at home—rather than a boom in exports—that generates the bulk of Taiwan’s gains (and the reason why Taiwan’s gains are greater than China’s).

The United States was respectful of the complexity of the cross-strait discussions that led to ECFA and refrained from openly communicating its own preferences with regard to cross-strait deepening. The Taiwan Strait is commonly referred to as the most serious potential security flashpoint in Asia—that is, the most likely to tangle global powers in a confrontation. Since the United States is committed to serving as security guarantor for a peaceful resolution of China-Taiwan differences, the geosecurity implications of closer cross-strait economic relations are certainly of interest. The United States will experience a modest direct

trade diversion impact from a fully implemented ECFA, a more significant impact in terms of Asia-Pacific economic leadership and momentum, and a very important but difficult-to-calculate impact on the security scene from altered political dynamics between Taipei and Beijing.

The United States should welcome a cross-strait economic agreement that supports Taiwan's economic interests without undermining other imperatives. It is better off with a prosperous Taiwan that can afford to chart its own future course. Cross-strait deepening *does* give rise to political and security concerns, but so does the status quo. Taiwan's wide-ranging prohibitions on imports from Chinese and investment are not effectively safeguarding the island. On the other hand, specific terms in ECFA, notably "joint industrial cooperation," may be a source of concern. The United States should clarify that such objectives, and ECFA as a whole, are WTO-consistent and precompetitive. China can encourage continued US support for the process by ensuring that ECFA is consistent with WTO standards for preferential trade agreements and by ceasing to impede Taiwan's participation in other economic liberalization accords, whether bilateral or plurilateral.

The forward-leaning trade policy agenda of China and Taiwan underscores the relative absence of the United States from Asian economic deepening. Five years ago few foresaw that Taiwan could undertake an FTA with Beijing before doing so with Washington. Now the first stage of that has come to pass. As some have pointed out, if the United States does not have a trade policy for Asia, it does not really have an Asia policy. President Barack Obama began to remedy this state of affairs in 2009, opening the way to deeper involvement with ASEAN and invigorating discussions of participation in the Transpacific Partnership, and the United States now looks ready to move ahead with a Korea-US FTA (KORUS). 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 is returning to lapsed Trade and Investment Framework Agreement (TIFA) talks with Taiwan—a good step. These discussions facilitate US-Taiwan progress on resolving trade and market access disputes, further preliminary discussions on bilateral investment, and—importantly—permit consultation on the nature of ECFA's joint industrial cooperation activities and other Taiwan-China initiatives that may raise concerns in Washington.

The United States must 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 of today is much more liberal than the totalitarian communist entity the United States courted to hedge against Soviet aspirations four decades ago. Middle-income China of the future may very well 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 where China, like the United States, is a first-order power.

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