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**The Political Impact of the Global Economic Crisis on Cross Strait
Relations**

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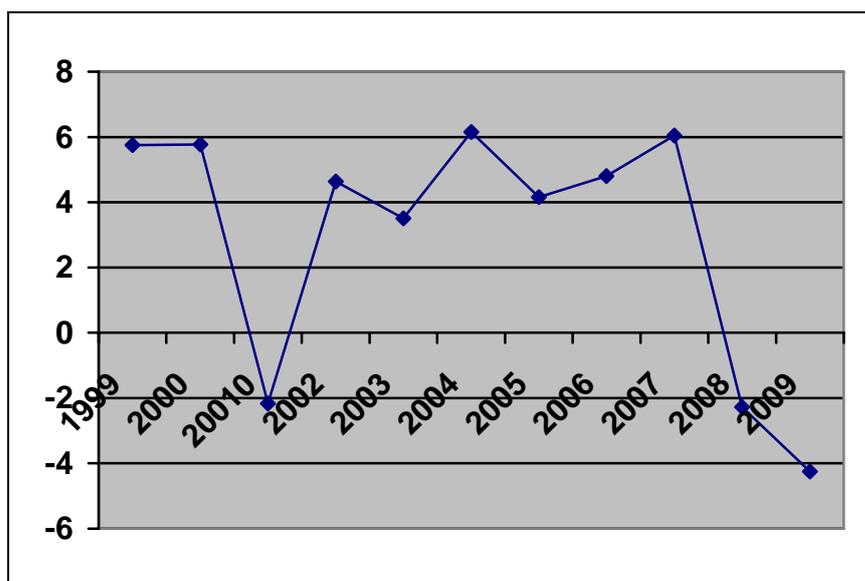
In the years leading up to Taiwan's 2008 elections a number of measures were planned by the CCP and the KMT to liberalise cross-Strait relations and give Taiwan's economy a substantial boost under a future Ma Ying-jeou administration. Few people predicted that in September 2008 this process would be thrown into turmoil by the deepening of the global financial crisis. Policies that had been devised for improving cross-strait relations in the context of growth in world trade and investment have had to be reassessed in the context of a recession in Taiwan and a serious slowdown of the mainland economy. How this interplay between economic policy and public opinion plays out will be crucial for shaping the future of cross-Strait relations. While it is too late to predict the outcome, this paper will explore the importance of cross-Strait economic relations for Taiwan's politics, make a preliminary assessment of the political impact of the economic crisis on cross-strait relations and point to some speculative scenarios for the future.

Cross Strait Relations Before the Global Economic crisis

It is fairly clear that high expectations for economic growth in Taiwan on the back of the liberalisation of cross-Strait transactions was one of the main policies that allowed the KMT to return to power in 2008. If nothing else, the elections that year established a strong link in the minds of Taiwanese citizens between their economic welfare and a political breakthrough with Beijing. This was made possible largely because the KMT campaigns were able to seize on and encourage the widespread lack of a 'feel good' factor among voters. It is important to explore this lack of a feel good factor in a little more detail, because it is likely to shape how the later impact of the financial crisis will be interpreted in Taiwan.

The first thing to note is that, despite widespread economic pessimism, by the standards of a developed economy Taiwan had actually been growing quite steadily before September 2008. As Figure 1 shows, its GDP growth stood at 5.7 percent in 2007, and had been around that figure for several years, having bounced back from the recession produced by the bursting of the dot-com bubble in 2001, just after the DPP gained the presidency.

Figure 1 Taiwan GDP Growth 1999-2009



Data: ROC Directorate General of Budget, Accounting and Statistics. 2009 provisional estimate)

One of the most frequently heard complaints in the run-up to the 2008 elections, however, was that Taiwan was falling behind the other Four Dragons, namely Singapore, Hong Kong and South Korea. This accusation was made not only by the KMT but also by influential foreign business groups, such as the European Chambers of Commerce in Taiwan.¹

On closer inspection, however, the proposition that Taiwan was falling behind the other Four Dragons due to the failure to liberalise cross-Strait transactions does not stand up to scrutiny. First of all, despite political tension between the Chen Shui-bian administration and Beijing, economic integration had deepened substantially between 2000 and 2008, with cross-strait trade growing 2.8 fold and the value of accumulated mainland-bound investment by Taiwan enterprises in China 3.8 fold. The mainland had become Taiwan's biggest trade partner, biggest export destination, and biggest source of trade surplus. It had also become the most important area for outbound investment by Taiwanese businesses.²

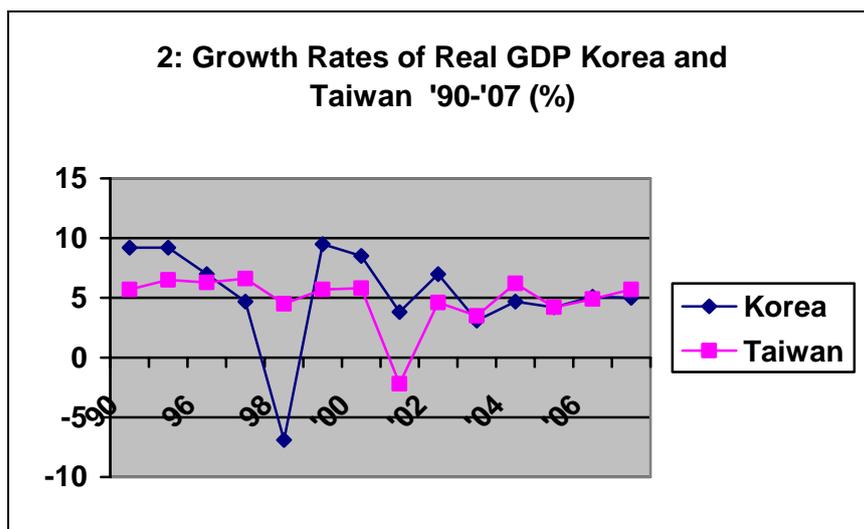
When we look at the comparison with neighbouring economies, the case is also not very clear cut. First of all, the tiny trading entities of Singapore and Hong Kong, which have for many years ranked near the top of global charts for their economic success, are not good comparitors for a primarily manufacturing economy like Taiwan. The only reasonable comparison is with South Korea. Here

¹ This case was made in some detail in the run-up to the elections in a special edition of the ECCT magazine, *Euroview*, 2007.

² Lai Shin-yuan (April 2009) <http://www.mac.gov.tw/english/english/macpolicy/980407e.htm>

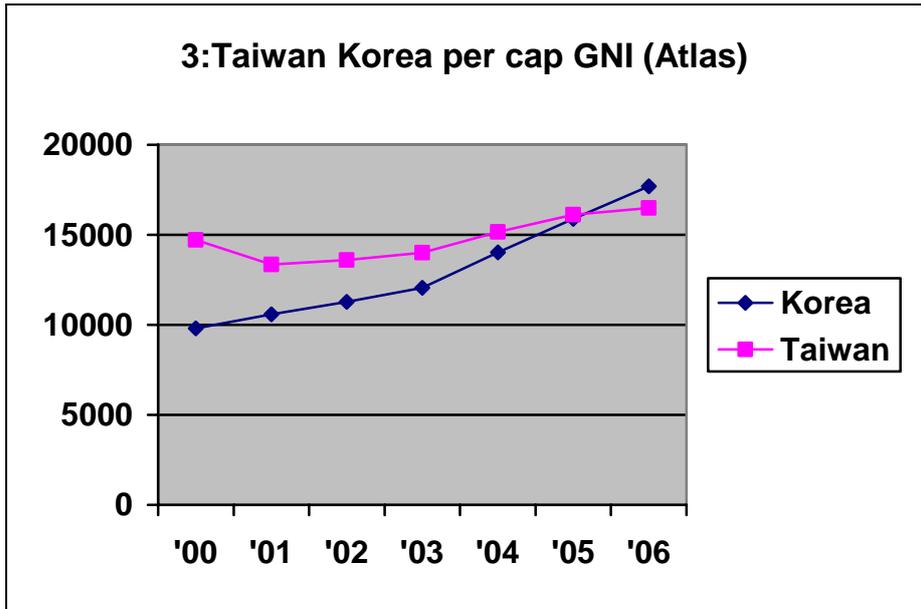
the case is not very convincing either. Even in terms of GDP growth, the ECCT could not come up with a very big difference, awarding a forecast of 4.6 percent to Taiwan for 2007, and 4.9 percent for South Korea.

As Figure 2 shows, if we use the ADB's statistics we see that there has in fact been a negligible difference between the GDP growth of Taiwan and South Korea since 2002, when the two economies rebounded from the bursting of the dot.com bubble. Moreover, the ADB figure for 2007 shows Taiwan's real GDP growth at 5.7 percent, which is ahead of South Korea's 5 percent.



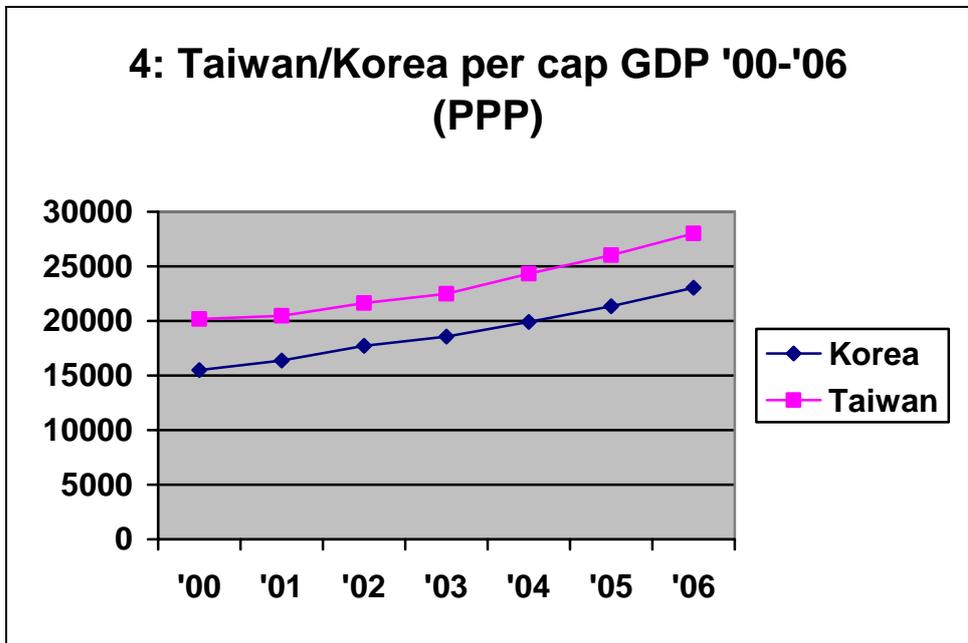
While GDP growth in itself may have symbolic significance for the a country is seen to be performing, far more important for the way individuals feel about the quality of everyday life is the level of personal income. Here again, the ECCT painted a negative picture for Taiwan, presenting its per capita GDP at USD 16,030 in 2006, compared to South Korea's USD 18,373. This figure, however, appears to be based on what is called the Atlas method of measurement, which gives the trajectories presented in Figure 3, showing South Korea overtaking Taiwan in 2006.³ Again, however, the difference is not particularly large.

3 The Atlas Method is the World Bank's official estimate of the size of economies. This uses GNI, which is the sum of value added by all resident producers plus any product taxes (less subsidies) not included in the valuation of output plus net receipts of primary income (compensation of employees and property income) from abroad. Data are in current [U.S. dollars](#), converted from countries' respective national currencies using the Atlas method, which uses a three-year average of exchange rates to smooth effects of transitory exchange rate fluctuations.



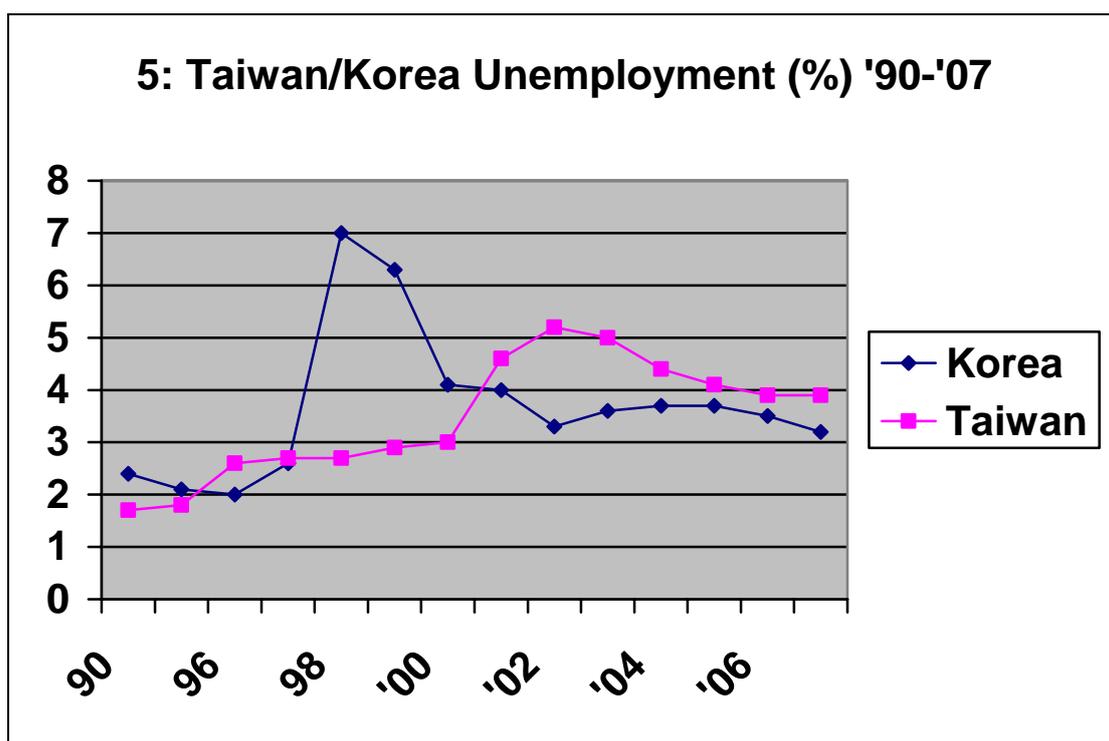
Source: Asian Development Bank http://www.adb.org/Documents/Books/Key_Indicators/2008/pdf/Key-Indicators-2008.pdf

A much better way to link GDP with the real standard of living is to use the Purchasing Power Parity (PPP) method. Figure 4 shows that when this method is used, Taiwan actually comes out consistently better off than South Korea.



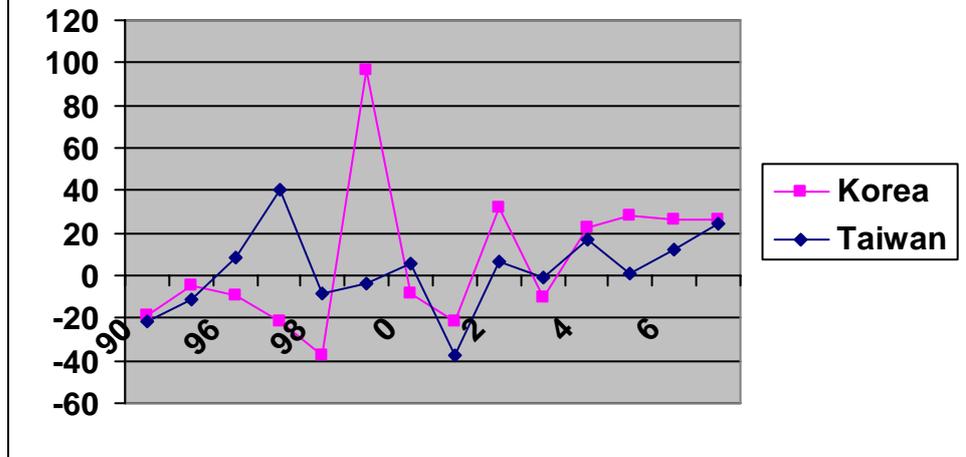
The rate of unemployment also has a significant impact on how voters feel. As Figure 5 shows, however, the difference here with South Korea is not particularly stark either. While Taiwan's rate of unemployment was slightly above that of South Korea between 2000 and 2007, both were on a downward to relatively

stable trajectory. Moreover, what difference there is in the two trajectories has to be understood in terms of the longer history of the ways in which the two economies were affected by the regional 1997 Asian Financial Crisis, and the global bursting of the dot.com bubble in 2000. While South Korea was affected far more dramatically by the former, Taiwan was hurt by the latter. As the economies recovered from these crises we can see that they return to a similar level of unemployment. This makes it doubtful whether their different policies towards China were a significant factor in explaining Taiwan's unemployment rate in 2008.



The one part of the economy where it is possible to find a divergence with South Korea that is big enough to have affected the sentiments of voters is the stock market. Figure 6 shows how stock prices in Taiwan and Korea followed a similar trajectory after the 2000 dot.com bubble, but began to diverge seriously in 2005 when Taiwan took a dive and then climbed back steadily over the following years to meet the level of Korea again in 2007.

6: Growth Rates of Taiwan and Korea Stock Market Price Indexes '95-'07



When this trajectory is correlated with political events affecting cross-Strait relations, then it is possible to propose a strong linkage that is no doubt driven by investor psychology. That is to say, the market took a dive after the re-election of Chen Shui-bian in 2004, then steadily recovered as the prospect of a KMT administration in 2008 became more and more likely. If this is the case, then it shows just how vulnerable Taiwan’s government is to political events and signals rather than economic transactions. This should be very significant for the way political parties behave, given that the stock market plays a vital role in determining the feel good factor in a society where small players are numerous.

The above data seem to suggest that if the lack of a feel good factor was significant in the change of government in Taiwan, it is not so much to do with the economic fundamentals involved with cross-Strait relations as it is the product of the need to adjust to a rate of development appropriate to a developed society after the rapid growth of previous decades. Indeed, the contrast of the present situation with the boom years of the ‘Taiwan miracle’ of the 1970s and 1980s was a very pronounced feature of the KMT’s election campaigns in 2008. Yet the fact that Taiwan did not under-perform South Korea too badly on indicators other than the stock market also shows how perceptions of the economy are sometimes driven not so much by fundamentals as by what behavioural economists call ‘animal spirits’, a view that is becoming increasingly popular after the failure of mainstream economics to explain the booms and busts that have afflicted the global system in recent years.⁴ It is important to bear this in mind when we look at the links between economics and politics since the financial crisis struck Taiwan.

⁴ See George A. Akerlof and Robert J. Shiller, *Animal Spirits: How Human Psychology Drives the Economy and Why It Matters for Global Capitalism*, Princeton University Press, 2009.

Assessing the impact of the financial crisis

Establishing how well Taiwan's economy performed before the return of the KMT to power is necessary for working out how important the global financial crisis has been in causing the present recession and how important cross-Strait relations will be in any recovery.

Assessing this is complicated by the fact that the KMT election campaigns and bodies like the ECCT strengthened the popular perception between further liberalisation of cross-Strait relations and Taiwan's welfare. The KMT even proposed that lifting the DPP's restrictions on cross-Strait transactions would deliver an extra 3 percent of GDP growth, substantially reduce unemployment, raise personal incomes and allow Taiwan to regain its global competitiveness. High expectations were thus raised on economic assertions that were rarely backed up by empirical evidence and did not take into account the progress that had already been made in cross-Strait economic liberalisation in the previous years.

In the first few months of the new KMT administration the programme of further liberalising cross-Strait economic relations was put into action. Adoption of the '92 Consensus' by the new administration in Taipei allowed the 'non-official' negotiations between the SEF and ARATS that had been broken off by Beijing in 1999 in response to ROC president Lee Teng-hui's 'two states theory' to be resumed.

Significant measures were rapidly agreed and implemented, including facilitation of the exchange of the RMB in Taiwan and, most significant, the opening up of the Big Three Links. These measures were supposed to stimulate Taiwan's economy by reducing business costs, with an expected influx of Chinese tourists boosting Taiwan's service sector and reducing unemployment by 1 percent.

We will never know how much extra value the Ma administration's economic policies would have delivered if the financial crisis had not struck after Lehman Brothers filed for bankruptcy on 15 September 2008. This external shock has, however, had a dramatically negative impact on Taiwan's export-oriented economy. The figures for the last quarter of 2008 show that its GDP contracted by a massive 8.36 percent year on year.⁵ Output fell by 32 percent in the 12 months to December 2008, and dived at an annual rate of 62 percent in the fourth quarter. Exports fell by a record 44 percent in the year to January and imports by a staggering 57 percent. Taiwan's citizens now face sharply rising unemployment rising with average wages falling by 5% in real terms over last year. Employees in many firms are being told to take unpaid leave and retail sales have slumped 11

⁵ 'Record Tumble in GDP pushes Taiwan into recession', Financial Times, 19 February 2009, 8.

percent. By February 2009 *The Economist* could claim that Taiwan had suffered from the slump more than any other country.

By the new year in 2009, there was a real danger that the economic crisis was crushing the high expectations that had been generated by the KMT and Beijing. By the end of November the number of passengers on cross-Strait flights was closer to 300 than the 3000 that Ma had envisioned in his election campaign. At the start of 2009 planes were flying at just 71 percent of capacity. Critics could claim that tourists accounted for less than 20 percent of these passengers, with the rest being mainly Taiwanese businessmen taking their business to China.⁶

In shipping, too, at the end of the year, Chang Yung-fa, the president of the enormous Evergreen shipping corporation, could point out that opening the Three Links had come too late to have a big impact on his own business. The decline in orders for Chinese goods from around the world had already reduced transport from Taiwanese ports to the mainland by 30 percent.⁷

That the small number was blamed at least in part on restrictions imposed by both sides on the size of tourist groups and only 40 extra flights per week were allowed for the Lunar New Year so that China had enough aircraft to meet its heavy internal demand, showed that political priorities also explain the disappointment.

Not surprisingly, concerns in Taiwan over the island's identity and status have grown as the economic boom that was promised on the back of better cross-Strait relations failed to materialise. By the start of 2009 opinion polls were showing a growing concern over the pace of the changing cross-Strait relationship. According to the Taiwan government's own figures, the proportion of people feeling that things were moving too fast had risen to 30 percent by December 2008, from a low of 19 per cent earlier in the year. The proportion of those judging the speed as 'just right' fell from 41 to 39 percent. Those wanting a faster opening up fell from 35 per cent to just 20 per cent.⁸ In January polls even began to register the highest ever levels in support of Taiwanese independence (23.5 per cent) and the lowest levels in favour of unification (6.5 per cent).

Searching for solutions

While the deterioration of the economic situation in Taiwan is due to international circumstances, Taiwan's government has also adopted measures on the domestic

⁶ 'Fei le zhongguo, shoule taiwan' (Fattening China and Slimming Taiwan', *Ziyou shibao*, 15 December 2008, A2.

⁷ 'Zhang Rongfa: mingnian xia ban nian hen can' ('Chang Yung-fa: The second half of next year will be truly terrible', *Jingji ribao* 31 December 2008, A1.

⁸ 'Minzhong dui liang an jiaoliu kaifang sudu de kanfa', ('Views of the Public on the Speed of Opening Cross-Strait Transactions'), Mainland Affairs Council of the ROC. Online: <http://www.mac.gov.tw/big5/mlpolicy/pos/9710/2.gif> (Accessed 7 January 2009).

front, cross-Strait relations and in its trying to attract foreign investment. This can be seen in Taipei's domestic stimulus package, which has involved the central bank cutting interest rates six times since September 2008, to 1.5%. The government also plans a fiscal stimulus of infrastructure investment, consumer handouts and tax cuts worth around 3% of GDP in 2009. To boost consumer spending, the government has given each citizen a voucher worth NT\$3,600 (\$106). One of the Ma administration's major policies has also been the inauguration of twelve major infrastructure projects, harking back to the policy orientation that the KMT used to engineer Taiwan's economic 'miracle' in the 1970s.

The high degree of integration with the Chinese economy, however, means that the cross-Strait relationship has to be a major part of the solution. A number of measures had already been put into the KMT's policy framework for deepening integration since CCP general secretary Hu Jintao met with then KMT chairman Lien Chan in 2005. Some of these have been explored and developed in more detail by influential figures in the new Ma administration, such as vice president Vincent Hsiao's work on the creation of a cross-Strait common market. Aside from further liberalising transport links, perhaps the most important among the economic measures are the signing of an MOU on financial cooperation and an FTA in the shape of a Common Economic Cooperation Agreement (CECA).

In the wake of the global financial crisis these proposals have been the focus of much attention. The prioritisation of financial cooperation in particular can be seen in a number of statements by leading policy makers. When PRC premier Wen Jiabao presented his work report to the National People's Congress on 5 March 2009, for example, he proposed the following measures to 'Comprehensively strengthen cross-Straits economic cooperation to jointly respond to the global financial crisis':

Actively promote financial cooperation across the Straits

Support the development of Taiwan-funded enterprises on the mainland

Provide financing services for qualified Taiwan enterprises and encourage their independent innovation, transformation and upgrading.

Strengthen two-way investment and industrial cooperation

Expand and deepen agricultural cooperation

Support economic development on the west coast of the Straits in Fujian Province and other areas where Taiwan investment is concentrated.

Accelerate normalisation of cross-Straits economic relations and facilitate the signing of a comprehensive agreement on economic cooperation

Gradually establish economic cooperation mechanisms tailored to both sides of the Straits.

The implementation of these policies has been taken forward in the latest package of agreements signed between SEF chairman Chiang Pin-kung and ARATS president Chen Yunlin on 26 April in Nanjing. This contained measures on a range of issues to increase transactions and deepen cooperation, including the launching of regular airline flights across the Strait and cooperation on fighting crime.

Of more direct relevance to the financial crisis, they also agreed to open Taiwan to investment from the mainland for the first time. The impact of this was quickly seen when, three days after the agreement, the mainland telecom giant China Mobile said it had reached an agreement to buy a 12 percent stake in Taiwan's third largest telecom operator Far EasTone for NT\$ 17.77 billion.

The mainland automobile manufacturer, Chery Automobile, quickly followed with an announcement that it will invest NT\$ 2 billion in a unit of Taiwan's Prince Motor to build cars in Taiwan for the global market. Mainland insurance companies such as Happy Life Insurance are also actively seeking opportunities to cooperate with insurance companies in Taiwan. It was also reported that a Taiwan source had said that a Guangdong-based real estate developer, Country Garden, is in the final stages of negotiations with Taiwanese real estate developer Farglory Construction to establish a joint venture. Each party plans to take a 50 percent stake in the venture, which would invest in Taiwan and the mainland.⁹ For Taipei, the improvement of cross-Strait relations is also expected to help increase the inflow of international funds into Taiwan. Some initiatives are already being taken in tandem with the liberalisation of cross-Strait finance to encourage this outcome, such as granting tax exempt status to offshore banking customers. Combined with the improved political situation, such measures should lead to a convergence of foreign funds, mainland funds and offshore Taiwan funds.

Not surprisingly such developments have stimulated the 'animal spirits' that are so important in driving economic cycles, not just on both sides of the Taiwan Strait, but also for foreign investors. The result has been a 44 percent gain for the Taiwanese stock market index between March and early May, far ahead of other Asian stock markets. It is unclear, however, what impact these rapid changes will have on Taiwan's longer term development. A number of causes for concern should be considered in this respect.

⁹ Xu Heqian, *Caijing Magazine*, 05-20 09??

Causes for concern

When assessing the impact of these policies to rescue Taiwan it is important to remember that the new administration in Taipei did inherit an already very high degree of economic integration with the mainland. If extraneous factors are to blame for the crisis, it may thus be misguided to rely too much on cross-Strait relations for a solution. The fact that the island's competitiveness has been dented by an appreciation of the New Taiwan Dollar by more than 40 percent against the South Korean won since the start of 2008, for example, is unlikely to be remedied by better relations with the mainland.

It might even be the case that Taiwan's growing dependence on the mainland economy has made the situation worse. With exports to the mainland now accounting for one quarter of Taiwan's total, whatever happens in China is bound to have a big impact on the island. Yet, with Chinese demand being hit by the economic crisis, this volume of exports declined by a massive 58 percent in 2008, twice as fast as the decline in exports to America. Moreover, the value of the NTD is likely to appreciate considerably further on the back of the heightened expectations fuelled by political breakthroughs.

Given the dangers of dependency on the mainland economy, from Taiwan's perspective what is required is greater regulation rather than ever increasing volumes of trade and investment. It would in fact be a mistake to assume that the return to power of the KMT has resulted in a complete liberalisation of cross-Strait relations given that a number of constraints have been kept in place due to concerns over their impact on the island's economic development, society and national security. These concerns over the impact of Chinese investment can already be seen in major deals that have hit the headlines since April. China Mobile's purchase of shares in Far EastTone deal, for example, has to wait for the green light from the Taiwanese government and will not give the Chinese firm the right to participate in daily operations, although it will have a seat on the board of directors.

This continuing caution is partly due to considerations by the government in Taipei, as it has come under increasing criticism from the DPP, the media and sections of the public and academia. The CECA, for example, has been portrayed and condemned for diminishing Taiwan's sovereignty because it looks similar to the CEPA between Beijing and Hong Kong and for exposing the island to possible risks of security and over-dependence on the mainland without any clear account of the costs and benefits. This is above all the case in agriculture, due to fears that opening to the mainland could worsen the plight of the island's farmers, who already face fierce competition under WTO rules.

Harried by the DPP and a rising tide of concern in the press and media, the Ma administration has thus re-branded the CECA as the Economic Cooperation

Framework Agreement (ECFA), reassuring the population that this is the weakest possible form of FTA and allows the retention of considerable control over trade and investment from the mainland. To allay more specific fears, agriculture will not be included in any FTA agreement and the movement of labour from the mainland has also been ruled out.¹⁰

The Ma administration has also been cautious about signing the MOU on financial cooperation, which has been lampooned as meaning ‘Money Out’ of Taiwan and portrayed as leading to the loss of control over key sectors of the economy to mainland investors. To allay such fears, Taipei has put in place a number of safeguards to constrain the influence of Mainland investors, such as limiting their investments to 10 percent of total QDII funds, or NT\$ 22 billion.¹¹ Mainland QDII funds that plan to buy more than 10 percent of a company will have to submit their investments for review by the Taiwan Investment Commission to avoid any real control by mainland companies of Taiwan listed companies through securities acquisitions. Meanwhile, the Ministry of Economic Affairs is drawing up rules designed to control investments by mainland companies in Taiwan, which should be completed by the end of May.

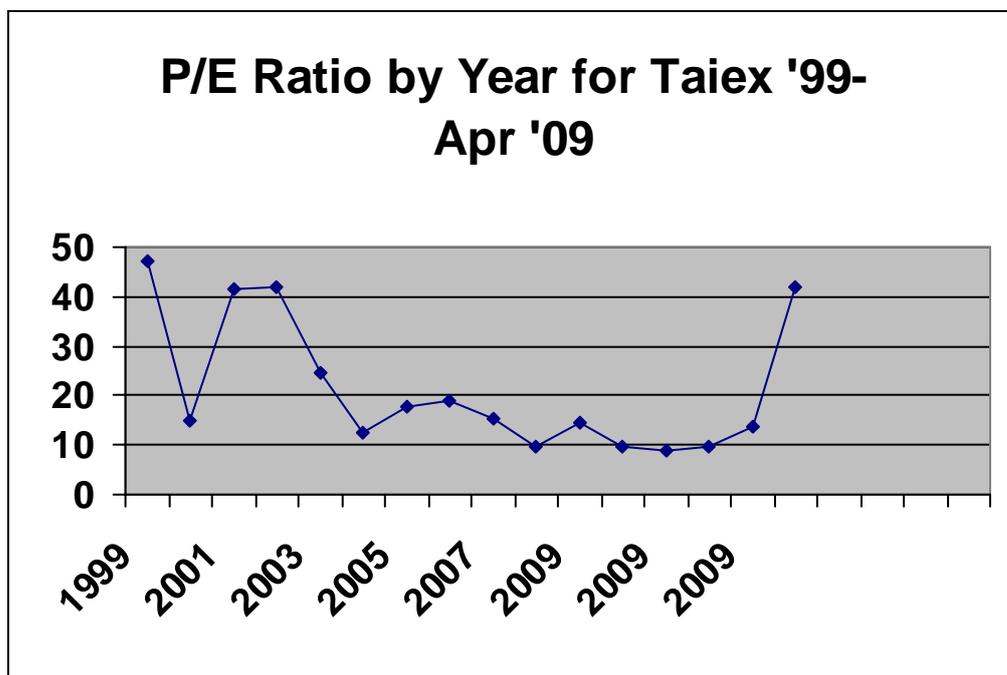
A more practical cause for concern is whether the inflow of Chinese capital will distort Taiwan’s development by ignoring economic fundamentals. Like other Asian polities, the island has had to weather the bursting of a number of speculative bubbles, most notably the 1997 Asian Financial Crisis and the 2000 dot.com bubble. There is particular concern over the impact on property prices, with Taipei already taking measures to avoid real estate speculation getting out of hand. This is an area that could have a particularly negative impact on public sentiment towards China, given that home prices on the island are already inflated and could become unaffordable for locals.

There is evidence that the signing of the 26 April agreement in Nanjing is already feeding a speculative bubble on the stock market. As Figure 7 shows, the ratio of prices to earnings for securities on the Taiwan Stock Exchange has reached levels similar to those at the time of the the dot.com bubble. Moreover,

¹⁰ For a detailed explanation of Taipei’s position on the ECFA see Mainland Affairs Council, *Cross-Strait Economic Cooperation Framework Agreement: Policy Explanation*, May 18, 2009. Online: http://www.mac.gov.tw/english/english/macpolicy/ecfa_exp.pdf

¹¹ **Qualified Domestic Institutional Investor** (合格境内机构投资者), also known as QDII, is a scheme relating to the capital market set up to allow financial institutions to invest in offshore markets such as securities and bonds. Similar to QFII (Qualified Foreign Institutional Investor), it is a transitional arrangement which provides limited opportunities for domestic investors to access foreign markets at a stage where a country/territory’s currency is not traded or floated completely freely and where capital is not able to move completely freely in and out of the country. In People's Republic of China, QDII allows investors to invest in foreign securities markets via certain fund management institutions, insurance companies, securities companies and other assets management institutions which have been approved by China Securities Regulatory Commission ("CSRC").

this surge has taken place in a remarkably short time, from a level of just 9.69 in February to a massive 41.81 in April.



A P/E ratio of 41.81 means that investors are paying prices for stock that has little if any relationship to the profitability of enterprises. No doubt this is driven by the optimism generated by developments in cross-Strait relations. Yet the economic fundamentals at present are not so encouraging. In fact, Standard & Poor's lowered the national investment rating outlook for Taiwan from stable to negative in mid-April due to deteriorating financial conditions and debt, even though the island did maintain its AA-rating. The International Monetary Fund (IMF) pointed out in its World Economic Outlook that Taiwan's GDP growth will be -1.5 percent in 2009, which is quite good by world standards but from a very low base of a massive contraction of -8.4 percent in 2008 and still lower than South Korea's expected 0 percent.¹²

Because this inflow of capital is caused by external factors it could easily be reversed and lead to a serious disappointment of what may be becoming overly optimistic expectations. The flow of funds may be vulnerable, for example, to a rise in interest rates that would offer better rates of return than investing in the securities of dubious value. Expectations that an economic boom on Taiwan will be driven by the mainland economy as Beijing's stimulus package leads to an expansion of consumer demand for items such as home appliances in rural areas are also contingent upon that plan continuing to work.

¹² IMF, *World Economic Outlook: Crisis and Recovery*, April 2009, p 190. Online: <http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/text.pdf>

Finally, despite the signing of nine agreements on liberalising cross-Strait transactions and the holding of three meetings between the SEF and the ARATS since the KMT returned to power in 2008, public opinion seems to accept the need for greater economic integration with the mainland but remains wary over the implications of this for sovereignty.¹³ Even after the recent agreements on cooperation were reached, the level of support reported in the MAC's poll showed that just 56.9 percent of the respondents believe that the outcome of the third Chiang-Chen talks upholds Taiwan's interests, while only 54.3 percent believe they do not dwarf the ROC's sovereignty.¹⁴

Despite these concerns, Taipei's spokesperson's have made it clear that they intend to further liberalise investments in the future, perhaps even establishing a mutual trading platform between Taiwan, the Mainland and Hong Kong by cross-listing exchange traded funds on their stock exchanges. To assess how this focus on integration with the Chinese market will shape Taiwan's economic development it is important to look a bit more widely at how it the island's place in the global economy.

Cross-Strait relations in the global context

This raises the interesting question as to how a massive inflow of Chinese investment will shape Taiwan's post-crisis economy, and in particular whether it will be good for those sectors that are most vital for it to emerge with a competitive edge in the global market. Again the Taipei administration appears to be adopting a relatively cautious stance in this respect, with strategically vital areas such as semiconductors, aviation, telecommunications, machines and the petrochemical industry not listed among the first sectors to feature on the investment opportunity list. Moreover, the financial and insurance industries will not be opened until the MOU is signed.

So far it appears that the first areas to be opened to investment from mainland companies will be limited to about 30 percent of manufacturing, 20 percent of the service industry, and 15 percent of public construction. According to the Mainland Affairs Council, Ma Ying-jeou's 12 major public construction projects will also be opened to mainland enterprise investments.

13 See MAC, 'Percentage Distribution of the Questionnaire on "The Public's Views on the Cross-Strait Economic Cooperation Framework Agreement and Mainland Investment in Taiwan', conducted 8-11 April 2009.

Online: http://www.mac.gov.tw/english/english/news/09419_2.pdf. According to this 55.0 percent of respondents believe that signing the ECFA will have a positive influence on advancing Taiwan's economy, 60.2 percent believe it will be conducive to 'Taiwan's internationalisation' and just 54.6 percent believe it will not dwarf Taiwan's sovereignty.

14 Mainland Affairs Council, 'Summarized Results of the Public Opinion Survey on the Third "Chiang-Chen Talks" (April 28-30 2009)'.

Online: http://www.mac.gov.tw/english/english/news/09505_1.pdf

This set of priorities reminds us that Taiwan is not only integrated into the Chinese economy but also into the global economy under the WTO regime. Much of the restructuring that took place during the DPP administrations was in fact driven by the need to open Taiwan's market not only to the mainland but also to foreign institutions after joining the WTO in January 2002. This global perspective creates an important counter-balance that should mitigate against over-dependence on the mainland economy. It also provides a legal framework within which cross-Strait economic relations can develop by sidestepping questions of sovereignty. As early as June 2001, for example, legislation was introduced to allow reciprocal financial agencies to be established on both sides of the Strait to manage financial exchanges between the two sides.

It is vital for Taiwan that deepening cross-Strait economic relations will be part of a much broader process that involves the internationalisation of the island's economy. This can be seen across a range of key sectors. Most salient among these in Taipei's current policy are the petrochemical, machine and auto-parts industries. This is because it has estimated that these are the sectors most threatened by the exclusion of the island from the emerging Asian regionalism, in the shape of the ASEAN+China FTA that is to begin on 1 January 2010, followed by agreements between Japan and ASEAN and ASEAN+3 (China, Japan, Republic of Korea). It is feared that maintaining relatively high tariffs on Taiwanese firms will force them to move offshore and result in the loss of jobs.¹⁵ One of the main arguments that the Ma administration uses to sell the idea of the ECFA to Taiwan's public is precisely that it will avoid such an outcome by opening the way for the island to sign FTAs with other states.

Another area where Taipei sees a link between improved cross-Strait relations and broadening its international space is in the future of the financial sector. This has been plagued by the existence of too many small and under-performing banks which have to be amalgamated to create bigger, more efficient institutions that can compete with foreign banks that are now allowed to operate in Taiwan under WTO rules. Common language, culture and the size of the Chinese market, as well as the fact that Chinese banks are in even more of a parlous state than Taiwan's, means that the mainland should be an ideal place to expand. Yet the ultimate aim is to internationalise the sector by making the island a regional financial centre.

By far the most important sector for Taiwan's export economy and its long-term development and up-grading is, of course, electronics. Here again, the linkage between cross-Strait relations and Taiwan's global presence is clear to see because a large proportion of Taiwan's exports to China are ultimately for assembly and re-export to the North American and European markets. While it is

¹⁵ Mainland Affairs Council, *Cross-Strait Economic Cooperation Framework Agreement: Policy Explanation*, May 18, 2009, p. 3. Online: http://www.mac.gov.tw/english/english/macpolicy/ecfa_exp.pdf

easy to blame the drastic decline in the sale of Taiwan's electronic components to the mainland on massive de-stocking by mainland businesses, the picture is in fact more complex because Taiwan's main exports in this sector, such as flat-screen monitors and semiconductors, were in oversupply even before the global financial crisis struck. The future of the DRAM industry, in particular, has been the subject of much agonising since this niche market has been dominated by South Korean manufacturers. In this respect, the global slowdown has merely deepened the structural problems facing the island's electronics industry.

Towards 'globalised regionalism'?

The challenge for Taiwan is thus maintaining its cutting edge advantages in the electronics sector through the kind of R&D activities that can only take place through active participation in the global economy, of which China is a vital but not the only part. The way forward in this respect has been described as 'globalised regionalism', which draws attention to the need to make any agreements with mainland China compatible with the WTO framework.

This is because Asian regionalisation itself is shaped not only by the rise of China, but also by the integration of big players such as the United States, the EU and Japan who have to work within the WTO regime, of which Taiwan is a member. This offers Taiwan the opportunity to further develop its industrial competitiveness and move up the value chain while avoiding the loss of its R&D facilities to mainland China by investing in the kind of research, education and training that will allow it to maintain its lead in engineering and management – the 'sticky assets' that allow it to add high value in global production chains.¹⁶

While Taiwan can no doubt continue to benefit from the competitive advantages offered by mainland Chinese manufacturing, it also needs to focus on the high end of the global production chain by continuing to set up electronics and software firms in places a far apart as Silicon Valley and the Czech Republic. It is only this global outlook that will allow access to the knowledge needed for advances in R&D, product definition, design, and marketing and branding transport costs to be minimised, while minimising the risks inherent in cross-Strait relations, be they epidemics, political instability, earthquakes or other unforeseeable events.¹⁷ This diversification of risk also maximises Taiwan's opportunities in the case of any radical restructuring of the global economy, such as a sharp appreciation of the RMB that would lead to rising production costs in

¹⁶ Berger, Suzanne and Lester, Richard eds (2005) , *Global Taiwan: building competitive strengths in a new international economy*, Armonk and London: ME Sharpe, p. 21.

¹⁷ Berger, Suzanne and Lester, Richard eds (2005) , *Global Taiwan: building competitive strengths in a new international economy*, Armonk and London: ME Sharpe, p. 27.

mainland China and a revival of export manufacturing in the United States and Europe.

That the government in Taiwan is well aware of these dynamics can be seen from the fact that it has been taking measures to strengthen its links with international firms even as it signs economic agreements with mainland China. Central to these is the attempt to attract multinationals to locate their key research, production and design and development centres on the island through offering excellent R&D facilities, and providing the right regulatory environment. Again, as in the financial sector, measures taken since WTO entry by Taiwan's economic bureaucracy have encouraged this inward tide with some success. This strategy has recently been continued and expanded, with plans to boost the domestic economy to the tune of US\$1 billion through investments made by overseas Taiwanese firms relocating to the island. The promise of very light penalties for Taiwanese businesses relocating their unauthorized operations from China back to Taiwan has also been continued under the Ma administration. By the end of 2008 the MOEA task force had handled a total of 228 investment projects totalling more than NT\$37.6 billion. Of this amount, NT\$33.5 billion involved Chinese mainland-based firms.¹⁸

In other words, Taiwan's economic strategy is focused on a vision of globalisation within which China plays a vital part, but not the only part. This is why improvements in the management of cross-Strait relations are welcomed not just by Taiwan and the mainland but also by international investors. The trick for Taiwan, however, is to ensure that it maintains its special role in these global production chains, becoming neither estranged from China nor over dependent in ways that might erode the competitive advantages it has built in sectors such as electronics. The need to maintain this balance should be borne in mind as Taiwan emerges from the financial crisis while enjoying a rapid expansion of transactions with the mainland and a large influx of Chinese capital.

The way forward: policy recommendations

While the global financial crisis has struck Taiwan particularly badly, this should not completely blind us to the longer-term processes that have been developing in cross-Strait economic relations for several years now. It has been argued above that assessing how the new forms of cooperation being worked out between Taipei and Beijing will affect these processes requires locating them within the much broader internationalisation of Taiwan's economy.

¹⁸ Adela Lin 'Government pulls out all stops in effort to lure businesses home', publication date : 02/06/2009

Looking at cross-Strait relations in the context of regionalism and globalisation makes sense from the perspective of the Ma administration because the future development of the island depends very much on the interplay between these spheres of activity. It should be pointed out that this is equally true for mainland China, given that over 60 per cent of all high-tech exports **from China** have been manufactured by Taiwanese companies. China also benefits enormously from Taiwanese investment, the cumulative total of which is conservatively put at over USD100 bn. The large number of Taiwanese business people, managers and technical experts living and working in China are also vital for China's technological upgrading.

In this respect, it is in the interests of all sides to ensure that the acceleration of economic integration between Taiwan and the mainland during the global crisis is balanced by a strengthening of the island's position in the regional and global economic systems, especially in the sectors where it is most competitive. This also requires allowing Taiwan to have a secure legal and political position in international society.

The hope that deepening economic relations with the mainland will be a way for Taiwan to become an active player in Asian regionalisation and globalisation may be problematic for Beijing. Yet allowing Taiwan to sign FTAs with other states may prove to be a far more important 'litmus test' of its intentions for the Ma administration than WHA participation. Allowing this to go ahead, though, will be necessary to consolidate the economic and political conditions for a positive outcome of increasing inter-dependency between the two sides of the Strait.

The PRC and the EU should thus work towards finding the appropriate formula to ensure that this can take place. This means living for some time with an interpretation of the '92 Consensus' that accepts both sides of the Taiwan Strait have the will for future political integration, but will uphold the present dispensation of sovereignty in the meantime. Such an approach will maximise the chances of avoiding a situation in which economic integration between the two sides of the Strait is seen by the public in Taiwan as happening too quickly and in ways that have negative impacts on Taiwan's society and the long term development of its economy. These negative impacts range from an over-dependence on the mainland that would leave Taiwan vulnerable to the 'animal spirits' of financial speculation, exposed to the uncertainties of China's economy and neglecting the need to focus on its own industrial upgrading. In the social sphere the dangers are legion, ranging from fears over the loss of control of the economy to outside forces to feelings of threat to Taiwan's native identity from an influx of tourists, business people and students from the mainland.

A more positive scenario is the strengthening of a Taiwan that continues to act as a link between China and the global economy. From the perspective of the Ma

administration, the necessary political formula for this is already in place not only in the form of the '92 Consensus' but also treating Taiwan as a separate customs territory of a Greater China Market, along with Hong Kong and Macao. This formula has been tried and tested for the WTO, and does not violate the '92 Consensus'. It is to be hoped that both the PRC and the EU will continue to build on this political compromise by finding ways to treat Taiwan as an equal entity and cease pressuring international organisations to further reduce its status.