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**Cross Straits Economic Relations:  
An Overview of the Present and Looking to the Future**

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# Cross Straits Economic Relations: An Overview of the Present and Looking to the Future

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## 1. Introduction

Since I last wrote my paper for this forum in 2011 on Cross-Strait economic relations – and more specifically on the landmark Economic Co-operation Framework Agreement (ECFA) – significant developments have occurred to these relations themselves and the wider regional and international contexts in which they are set. Cross-Strait economic relations still matter for three main reasons. Firstly, they remain the most substantiated links that bind mainland China and Taiwan together, and the principal facilitator of fostering other forms of relations, e.g. socio-cultural, people-to-people. Secondly, the mainland China – Taiwan economic relationship is globally significant. Trade and investment flows between both sides remain sizable and moreover involve important hubs of global industrial activity. This is especially relevant to the electronics and information communications technology (ICT) sectors, where production networks and supply chain relationships among mainland Chinese and Taiwanese firms are incredibly dense, and together they are the world's major manufacturing centre of key products from these industries. Thirdly, Cross-Strait economic relations are a critically important conduit through which governments, businesses and people from both sides can address future development challenges ahead at the local, regional and global scales. This particularly relates to climate change, energy security and low carbon development generally. In this paper, I will overview recent developments in Cross-Straits economic relations and then consider future development challenges lying ahead for mainland China and Taiwan, and how those relations could evolve over forthcoming years and decades in light of those challenges.

## 2. Recent Developments in Cross-Straits Economic Relations

### *2.1 Trade and Investment Flows*

Over the last decade, Cross-Strait trade has almost quadrupled. According to Taiwan's Bureau of Trade, in 2003 the bilateral trade flow was US\$ 33.9 billion, with Taiwan exporting over twice that it imported from mainland China (Table 1). By 2013 this figure stood at US\$ 124.4 billion. Mainland China government statistics are more or less aligned with its Taiwanese counterparts on Taiwan's imports from the mainland but its statistics on export flows are considerably

higher. Such statistical misalignments are common between bilateral trade partners but both sides calculate the same trade patterns.

Some key points to note. Cross-Strait trade is *functionally integrated* from a business perspective as Dr Brown’s paper no doubt elaborates in some detail. Much of the trade that occurs – especially Taiwan exports to the mainland – is production network trade whereby Taiwanese firms are sending components and sub-assembled parts to their investment operations located in the mainland. This is trade occurring within the same integrated business system that often forms part of much larger regional and global production networks. These trade-investment based networks have formed their own Cross-Straits economic space that over time has been more densely developed, and defines in many ways the very nature of economic relations across the Strait. Goods made in the space serve larger global markets.

*Table 1: Taiwan’s Trade with Mainland China, 2003 – 2014*

	<b>Imports (US\$ million)</b>	<b>Exports (US\$ million)</b>	<b>Balance ratio (exports to imports)</b>
<b>2003</b>	11,017	22,890	2.08
<b>2004</b>	16,791	36,349	2.16
<b>2005</b>	20,093	43,643	2.17
<b>2006</b>	24,782	51,808	2.09
<b>2007</b>	28,014	62,416	2.22
<b>2008</b>	31,390	66,883	2.13
<b>2009</b>	24,422	54,248	2.22
<b>2010</b>	35,945	76,934	2.14
<b>2011</b>	43,595	83,959	1.92
<b>2012</b>	40,907	80,713	1.97
<b>2013</b>	42,588	81,787	1.92
<b>2014 (Jan-June)</b>	23,043	40,307	1.74

*Source:* Taiwan Bureau of Foreign Trade ([www.boft.gov.tw](http://www.boft.gov.tw))

During the last decade, Taiwanese business investment in the mainland has also gradually increased but has proved much more volatile on an annual basis than trade. Statistics on Cross-Strait investment, and also on foreign direct investment (FDI) generally, are still notoriously unreliable and inaccurate. Current estimates on investment flows from Beijing and Taipei are thought to both underestimate actual investment flow amounts and the number of Taiwanese firms operating across the Strait. Since 2003, mainland China is thought to have attracted at least two-thirds of all Taiwanese ‘overseas’ investment and by the early 2010s was probably around 80 percent of this total. Recent figures show a relative downturn in Taiwanese business investment in China during 2012 and 2013. This is mainly

apparent in the crucially important electronics and ICT industries, where there has been a shift in production undertaken by major firms from China to other fast-growing developing countries (e.g. Vietnam, Indonesia) as well as to the United States, where cheap energy prices arising from the shale gas revolution has made the country a competitive place again to produce energy-intensive products. Rising wages in China's more prosperous provinces such as Guangdong and Fujian have also led to Taiwanese companies looking for alternative production options. This is another reminder of how Cross-Strait economic relations are in many ways a function of the global economy, and are significantly shaped by it. If mainland China becomes a more post-industrial economy, this will have major implications for Taiwanese firms. Furthermore, while hitherto the Cross-Strait investment relationship has been largely uni-directional (i.e. Taiwan investment on the mainland), this could change should ECFA and its related future agreements permit mainland Chinese investors wider scope to invest in Taiwan.

## *2.2 ECFA and Related Agreement Initiatives*

Beijing and Taipei signed the Economic Co-operation Framework Agreement (ECFA) in June 2010 after around a year period of formal feasibility studies and negotiations. ECFA is *not* a free trade agreement, rather what is referred to as a partial scope trade agreement due to only a limited range of liberalised (i.e. zero or near zero tariff levels) goods covered in the pact. The centerpiece of the 2010 agreement was the 'Early Harvest' tariff liberalisation component involving 539 Taiwan product lines and 237 China product lines. There are typically around 10,000 product lines for trade partners to potentially negotiate on, so ECFA only presently covers around 8 percent of the total. Moreover, the core text of the agreement is only seven pages long. By contrast, FTAs signed by many Asia-Pacific countries typically run to well over 100 pages or more. The FTA chapters on intellectual property rights usually brokered by the US alone normally run to twice the current length of ECFA (Dent 2010a, 2013). However, the intention was always from the start for ECFA to evolve and develop into something more substantial, or at least the lay the foundation for other agreements to further open up and expand Cross-Strait economic relations.

Indeed, there is a stated commitment in ECFA's text to "gradually reduce or eliminate tariff and non-tariff barriers to trade in a substantial majority of goods", and a similar commitment on future services trade. It further identified 11 sectors for services trade liberalisation in China (including accounting, banking, healthcare, insurance) and 7 sectors in Taiwan (including banking and cinema). Furthermore, PRC investors were to be allowed to take 10 percent stakes in Taiwan's technology companies. The Cross-Straits Economic Co-operation Committee was established in February 2011 and charged with overseeing the

future development of ECFA and related initiatives. This included the Cross-Strait Service Trade Agreement (CSSTA) signed in June 2013 but has yet to be ratified by Taiwan's legislative Yuan. Under this deal, Taiwan would open up 64 service industry sectors to mainland China (e.g. banking, insurance, medical service, securities brokerage, technical certification and analysis, and tourism) while the latter would open up 80 sectors to the former (e.g. banking, retail, cultural industries, e-commerce, insurance, securities brokerage, technical certification and analysis, and transportation). Taiwanese firms have been long used to operating in mainland China's domestic markets, albeit it principally in manufacturing, but if ratified and thus entering into force the CSSTA would permit many mainland Chinese firms their first real substantive experience of conducting business and working in Taiwan. From commercial and people-to-people exchange perspectives it would foster a more bi-directional economic relationship. Whereas manufacturers can simply send over the products to the other side of the Strait if they are engaged in simple exporting activity, service industry providers have to become embedded in the local market. An in force CSSTA could potentially lead to a significant rise in mainland Chinese living and working in Taiwan. The island economy is already very services industry oriented, with services accounting for 69 percent of Taiwan's GDP and 59 percent of the workforce.

Those elements of Taiwanese society opposed to the CSSTA have raised concerns of the agreement – like ECFA before it – of opening up Taiwan's economy and job market to far too mainland Chinese business and workers, and more broadly exacerbating Taiwan's economic dependence on the mainland. Certain sections of the Taiwanese business community have expressed worry over Cross-Strait trade patterns since ECFA came into force in September 2010. As Table 1 indicates, the balance ratio of Taiwan's exports to imports in its mainland China trade was at least 2.0 up to 2010. This changed thereafter, falling below this level, reflecting a much faster increase in imports over exports. There are of course a number of variables we have to consider regarding the determinants of bilateral trade flows. The aforementioned recent relocation of production and manufacturing investment from China to elsewhere have meant that Taiwanese firms have not been exporting production network components and parts in the same quantities as previously. In addition, recent downturns in expenditure in mainland China as part of trying to address the countries fiscal and debt issues has lead to a drop in demand for Taiwanese firm made luxury products.

Public opposition to the CSSTA, led by the recently formed 'Sunflower Movement' from March 2014, had led to a delay in the agreement's ratification, which in turn postponed the negotiation of its sister Cross-Strait Goods Trade Agreement (CSGTA) that were supposed to start in April 2014. The CSGTA is intended as the second phase of ECFA goods trade liberalisation after the initial 'Early Harvest' phase. Under this planned agreement it was hoped that tariffs on

over 5,000 product lines would be eliminated or substantially reduced. There were indications in early September that despite the delay in the CSSTA's ratification, preliminary CSGTA talks may soon proceed. In the meantime, Beijing and Taipei have signed 18 other sectoral-based agreements aimed at broadening economic and other forms of co-operation across the Strait.

### *2.3 Wider Regional Contexts of Cross-Strait Economic Relations*

From the Taiwanese perspective, ECFA was supposed to provide the Taipei with the legitimacy to sign trade agreements with other trade agreements, especially FTAs. Taiwan has been left behind in the regional and global proliferation of FTA activity since the late 1990s, sparking concerns over international economic marginalisation. However, the fact that ECFA remains a basic 'partial scope' trade agreement rather than an FTA has not helped its cause. Taipei has only managed to sign full FTAs with a small handful of Central American states, and Beijing has the power – should it wish to exercise it – to deter most other states considering the initiation of FTA negotiations with the Taiwanese government. While Taipei was able to sign an economic co-operation agreement with New Zealand in July 2013, this is not seen by any side as a precursor to commencing bilateral FTA talks.

But do FTAs actually matter? Do they make any difference to business, the main 'clients' or 'customers' these pacts are supposed to serve and be utilised by? The evidence from East Asia and the Asia-Pacific is not clear, and Taiwan's firms in most key industries appear to have been nimble and flexible enough to deal with relative disadvantages they have faced where denied the same 'free trade' preferences enjoyed by their rivals (e.g. from South Korea) in foreign markets. Furthermore, tariffs matter far less than in the past, especially in key sectors like electronics and ICT where they are now virtually zero. Exchange rate fluctuations can have a much greater effect than tariff changes in such circumstances.

Although the FTA trend both from the Asia-Pacific regional perspective and the global perspective has hitherto been predominantly bilateral in nature (around 85 to 90 percent of the agreement total) there has been a shift to 'grand regional' FTA projects over most recent years. In addition to the Transatlantic Trade and Investment Partnership (TTIP) talks noted in Dr. Wacker's paper between the United States and European Union, there currently *three* other grand regional FTAs in negotiation that centre on the East Asia region, as shown in Figure 1. Starting with the smallest, China, Japan and South Korea have proposed a Northeast Asia Free Trade Area (NEAFTA), to which Taiwan would seem geographically at least eligible to belong. Although essentially only a trilateral arrangement, it comprises the world's second, third and eleventh largest economies. Secondly, negotiations on the Trans-Pacific Partnership (TPP) – led by

the United States and involving 12 Asia-Pacific countries but most notably not China – have been stumbling on for some time and have already missed three target deadlines for concluding talks. Third is the Regional Comprehensive Economic Partnership (RCEP) based on ASEAN Plus Three membership (China, Japan, South Korea and Southeast Asia) and in addition Australia, India and New Zealand, negotiations on which began last year.

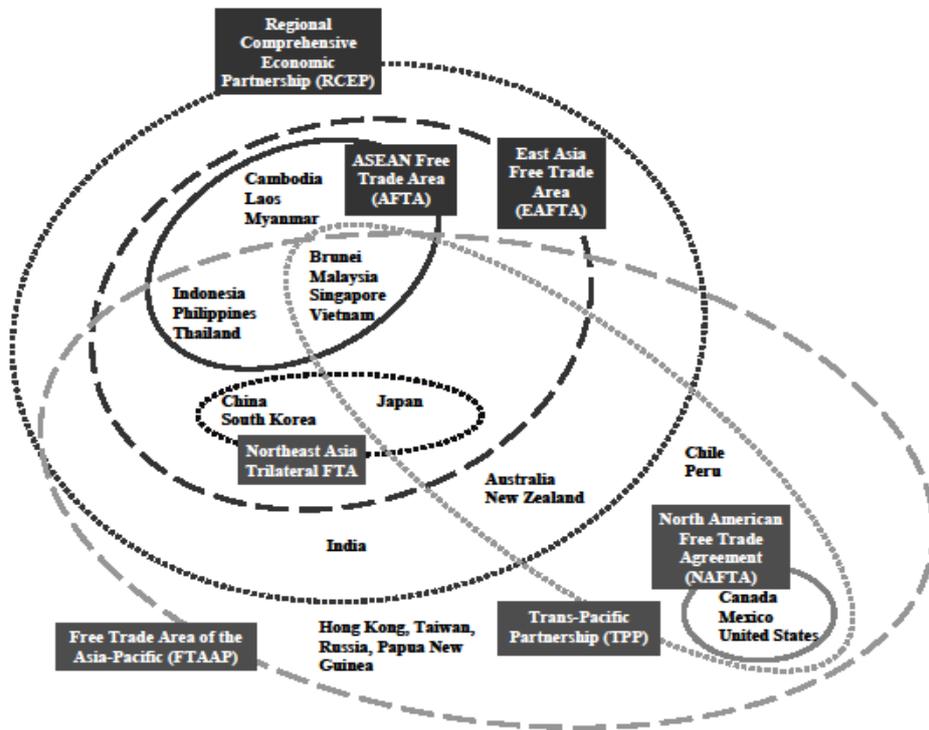
Both DPP and KMT Taiwanese governments have been keen to join in such regional arrangements not just for economic reasons but perhaps more importantly geopolitical motives due to what these arrangements might become in the future in terms of deeper regional community-building. Having studied FTAs for some time, it is my humble view that while there is a relatively strong chance of basic-level NEAFTA and RCEP agreements coming into force, the TPP's prospects of success are significantly slimmer for reasons I am happy to discuss during my presentation. In essence, the TPP is too ambitious from a commercial regulatory perspective (e.g. on intellectual property and investment rights, as well as government procurement rules and financial service regulations), and moreover based on a rigid FTA template or model being driven forward politically by the dominant negotiating party, the United States. In my view even if, by some minor miracle, a TPP deal is eventually concluded by international negotiation, it is quite another political challenge to actually ratify the agreement into the many domestic legislatures involved. Let us not forget the story of its closest parallel FTA project, the Free Trade Area of the Americas (FTAA) negotiations, which were also led by the United States just a decade back and too involved a highly diverse trans-regional grouping of countries, and that abjectly failed due to steadfast resistance (mainly from Brazil) to adopt US-oriented economic rules. In 10 years from now we may have also forgotten the TPP. Furthermore, the RCEP and NEAFTA are tighter geographic groupings in which the core parties all adhere in their own ways to the 'economic partnership' principle, namely that commercial liberalisation is balanced with economic co-operation and mutual development capacity-building measures. Thus, they are more potentially conducive to regional community-building, where in contrast the TPP is essentially a comprehensive business deal that especially favours sophisticated and powerful service sector firms – what Washington euphemistically refers to as a 'platinum standard' FTA. Another relative strength of the RCEP and NEAFTA projects is that its leader nations have demonstrated far greater flexibility in negotiating FTAs in comparison to rigid structured approach of the United States (Dent 2010b, 2013, 2014a).

China will be at the centre of any future concluded RCEP or NEAFTA, and these agreements do actually come into force in the future they will significantly impact on Cross-Straits economic relations. Again, I am happy to discuss how in my presentation. In my view, Taipei is wasting valuable diplomatic efforts trying to accede to the current TPP talks. Instead, the RCEP is a much better prospect for

the reasons noted above, although Taiwan's chances of acceding to these talks are narrow due to Beijing's position on the matter. Even if a full Cross-Straits FTA existed (bilateral or sub-regional FTA links are in force among most RCEP members already) it is doubtful whether any Taiwanese government will succeed in becoming a negotiating party.

**Figure 1** Regional FTA Projects in East Asia and the Asia-Pacific

Note: Unbroken line indicates regional FTA already in force. Dotted line indicates regional FTA under negotiation by 2014. Dashed line indicates regional FTA at the proposal only stage.



### 3. Looking to the Future of Cross-Straits Economic Relations

The world is changing around the economic relations that exist between mainland China and Taiwan. This relates not just to important technological, political and socio-cultural change, or an ever integrating global economy, but also to major challenges facing humanity in the 21<sup>st</sup> century, and these challenges are becoming ever more acute. Climate change, energy security, resource competition, food security and global poverty have become new priorities in international diplomacy worldwide. All present existential risks to humankind in their own way and cannot be ignored. Mainland China and Taiwan are located in the most carbon-intensive region on the planet. Both have very similar motives and needs to establish low(er) carbon development paradigms in their economies and societies. Both also are

world-leaders in key green industries, such as Taiwan in LED and energy efficiency technologies, and mainland China in solar photovoltaic and wind energy. While we have seen in EU – China relations that trade disputes can arise in such sectors, Taiwanese and mainland Chinese businesses have already well established business network relationships and are collaborating across a wide range of industries, including increasingly in those that can deliver low(er) carbon development. Under the 12<sup>th</sup> Five Year Plan and other strategic planning frameworks, Beijing is seeking to promote ‘indigenous innovation’ and advance green industry development (Dent 2014b). Taipei’s Green Energy Industry Sunrise Plan and New Energy Policy to 2030 have similar objectives (Dent 2014c). Over time, the aforementioned Cross-Straits economic space could become increasingly defined by green industry business networks, and the economic diplomacy agenda focused on co-operation and commercial disputes in these sectors. Cross-Straits economic relations have long served the needs of global markets, and perhaps one day they will be viewed as helping address a crucial global challenge, should green industry business collaboration between mainland Chinese enterprises and Taiwanese firms flourish.

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