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Taiwan's Economy Needs More Than Cooperation with China

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Perhaps the most prominent reaction to progress in trade and investment talks between China and Taiwan is that the dialogue is long overdue. From Taiwan's perspective, such an assessment turns out to be exactly right—cross-straits economic liberalization is *overdue*. In pure economic terms, it would have been far better for Taiwan if liberalization had occurred 15 or so years ago. Possible gains from cross-straits economic liberalization are just not what they used to be.

At this point, while more openness in cross-straits trade and investment is certainly worth pursuing, Taiwan's economic strategy must encompass other fundamental needs as well: internal economic restructuring and the cultivation of new and dynamic foreign relationships beyond the Straits.

Trade and Taiwan's Internal Economy. More open trade and investment offers outright benefits, both direct and indirect. The direct benefits are greater opportunities for consumers from cheaper and more varied goods and greater opportunities for firms to operate in the new foreign market.

The indirect benefits come from incentives from overseas markets that push Taiwanese business toward sectors where Taiwan has a comparative advantage and competition from outside firms and products that increases efficiency at home. Often the indirect benefits are larger than the direct benefits, and preliminary research indicates that this is the case with an economic cooperation and framework agreement (ECFA) with China as well.¹

The catch is that Taiwan can and should engineer many of these internal efficiency improvements on its own. Long overdue reform of corporate taxation would both push economic activity toward comparative advantage and make Taiwanese firms more competitive. Reform of the sheltered domestic service sector, especially in finance, would lower costs for consumers. Joining the WTO's Government Procurement Agreement would ease the burden on the government to finance its projects and strengthen Taiwan's position in international economic negotiations.²

These steps would replicate the benefits of an agreement with China and, naturally, do so to a greater extent, since not all of the economy is involved in commercial exchange with the PRC. There are, of course, sizable political obstacles to substantial economic reform. But there are also, of course, sizable political obstacles to substantial cross-straits economic liberalization. Internal reform goes directly to the most beneficial changes that cross-straits liberalization would bring.

Portfolio Diversification. It may be difficult to imagine how the centerpiece of Taiwan's economic strategy could be anything other than more open

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trade and investment with the PRC. The PRC will shortly be the second largest economy in the world and, barring catastrophic events, will be one of the four largest economies indefinitely, perhaps even becoming the largest within a generation.³ Such a market is obviously a powerful attraction to an island of 22 million people less than 150 miles off the Chinese coast. However, the most lucrative years for Taiwan–China business and trade have already passed.

As an investment, China is moving from a “growth” stock to a “value” stock. In terms of raw growth, the days of 14 percent GDP gains in the ‘90s and 12 percent GDP gains earlier this decade are gone, to be replaced (after the post-crisis bounce) by long-term growth of about 8 percent annually. And that is if all goes well.⁴

Specifically, the PRC’s successful globalization means there are fewer opportunities left for Taiwanese companies. In the 1980s, the mainland desperately needed intermediaries to connect more fully to the outside world. That is no longer the case.

In the 1990s, China became one of the centers for global production. This process involved several hundred billion dollars of investment from elsewhere in East Asia for the purpose of relocating production to the PRC.⁵ Preferential access for Taiwan at that time would have been economic and commercial gold. Now, China’s cost advantages are at risk, and production will inevitably begin to move elsewhere. Both the mainland as a source of dynamism for the Taiwanese economy and Taiwan play-

ing a pivotal role in mainland development in return are therefore waning—not waxing—forces.

Beyond China, a central Taiwanese motivation in negotiating ECFA is to secure access to trade pacts involving the Association of Southeast Asian Nations (ASEAN), with which the island has considerable economic ties.⁶ But there is no guarantee, even with an ECFA, that China will tolerate ASEAN extending such pacts to Taiwan. Further, the Taiwanese economic relationship with ASEAN shares the critical feature of the cross-straits relationship: a current lack of dynamism.

Other options should therefore be cultivated. In particular, Taiwan should seek partners poised for a period of especially rapid growth, better positioned to achieve rapid gains from fresh globalization, and in greater need of Taiwanese technology and service industries.

An obvious candidate is India. India is now entering a demographic expansion of similar magnitude and importance to the one the PRC is leaving.⁷ Technology is an Indian strength but India’s service sector offers many opportunities for mutual gain from Taiwanese investment. And, just as with the PRC earlier in the reform process, the potential size of the Indian economy makes opportunities for Taiwan effectively limitless. In some ways, India is China 15 years ago, with a decade of 12–13 percent growth potentially available, to be then possibly followed by the same 8 percent annual expansion China now seeks.

1. Daniel H. Rosen and Zhi Wang, forthcoming report from the Peterson Institute of International Economics.
2. See, for example, “Steering out of the Storm: Swiftly and Forcefully” European Chamber of Commerce Taipei, November 26, 2008, at http://www.ecct.com.tw/index.php?option=com_content&task=view&id=295&Itemid=162 (November 8, 2009).
3. World Bank, World Development Indicators Database, October 7, 2009, at <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf> (November 8, 2009).
4. See Yasheng Huang, *Capitalism With Chinese Characteristics: Entrepreneurship and the State* (Cambridge University Press, 2008).
5. Guillaume Gaulier, Françoise Lemoine, Deniz Ünal-Kesenci, “China’s Integration in East Asia: Production Sharing, FDI and High-Tech Trade,” CEPII, June 2009, at <http://www.cepii.fr/anglaisgraph/workpap/pdf/2005/wp05-09.pdf> (November 9, 2009).
6. Central News Agency, “ECFA Can Create over 105,000 job Opportunities in Taiwan: Report,” *Taiwan News*, October 21, 2009, at http://www.taiwannews.com.tw/etn/news_content.php?id=1087676&lang=eng_news&cate_img=logo_taiwan&cate_rss=TAIWAN_eng (November 8, 2009).
7. Derek Scissors, “People, Growth, and Reform: China’s Uncertain Future,” Heritage Foundation *WebMemo* No. 2032, August 21, 2008, at <http://www.heritage.org/Research/AsiaandthePacific/wm2032.cfm>; Derek Scissors and Michelle Kaffenberger, “U.S.–India Relations: Ensuring Indian Prosperity in the Coming Demographic Boom,” Heritage Foundation *Backgrounder* No. 2274, May 15, 2009, at <http://www.heritage.org/Research/AsiaandthePacific/bg2274.cfm>.

The U.S. Role. More open Taiwanese trade and investment with China fits the principles of American foreign policy. Diversification of economic efforts, however, will result in a more vigorous Taiwan. And a more economically dynamic, secure Taiwan is good for peace, stability, and prosperity in the region.

The U.S. should assist Taiwan in this effort, starting with U.S.–Taiwan trade and investment. ECFA is not the only way to open up the possibility of other bilateral agreements for Taiwan. A U.S.–Taiwan FTA, for instance, would provide a powerful example for other potential partners.

Most important is internal Taiwanese restructuring. It will yield the greatest economic benefits for the island and be shared with all of Taiwan's partners. American policy should be shaped accordingly.

Recommendations:

- Taiwan should undertake a set of domestic economic reforms aimed at spurring efficiency and growth prior to, or coincident with, the implementation of steps toward more open cross-straits trade and investment.
- Taiwan should ensure that its regulations, taxes, and international economic agreements do not artificially divert trade and investment toward

the mainland or any East Asian bloc at the expense of India or other promising partners.

- The U.S. should support cross-straits liberalization while verifying that it does not spark fresh discrimination against American products and companies in the name of preferential access for the parties. The U.S. should ensure that the WTO reciprocity principle is observed upon completion of any and all mainland agreements with Taiwan.
- The U.S. should pursue its own trade and investment liberalization with Taiwan, culminating in a robust free trade agreement and bilateral investment treaty.
- The U.S. should take low-profile diplomatic steps—when fruitful—to encourage countries to negotiate (WTO-consistent) economic arrangements with Taiwan.

Cross-straits liberalization is valuable, but it is only one arrow in the quiver. More needs to be done to bolster Taiwan's economic future, and America can help.

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